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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 765

THE GRAYSON SHOPS INCORPORATED (OF CALIFORNIA), NAME CHANGED TO GRAYSON-ROBINSON STORES, INC.,
Petitioner,

v.

HERBERT B. STONE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

DAVID MARRAY,
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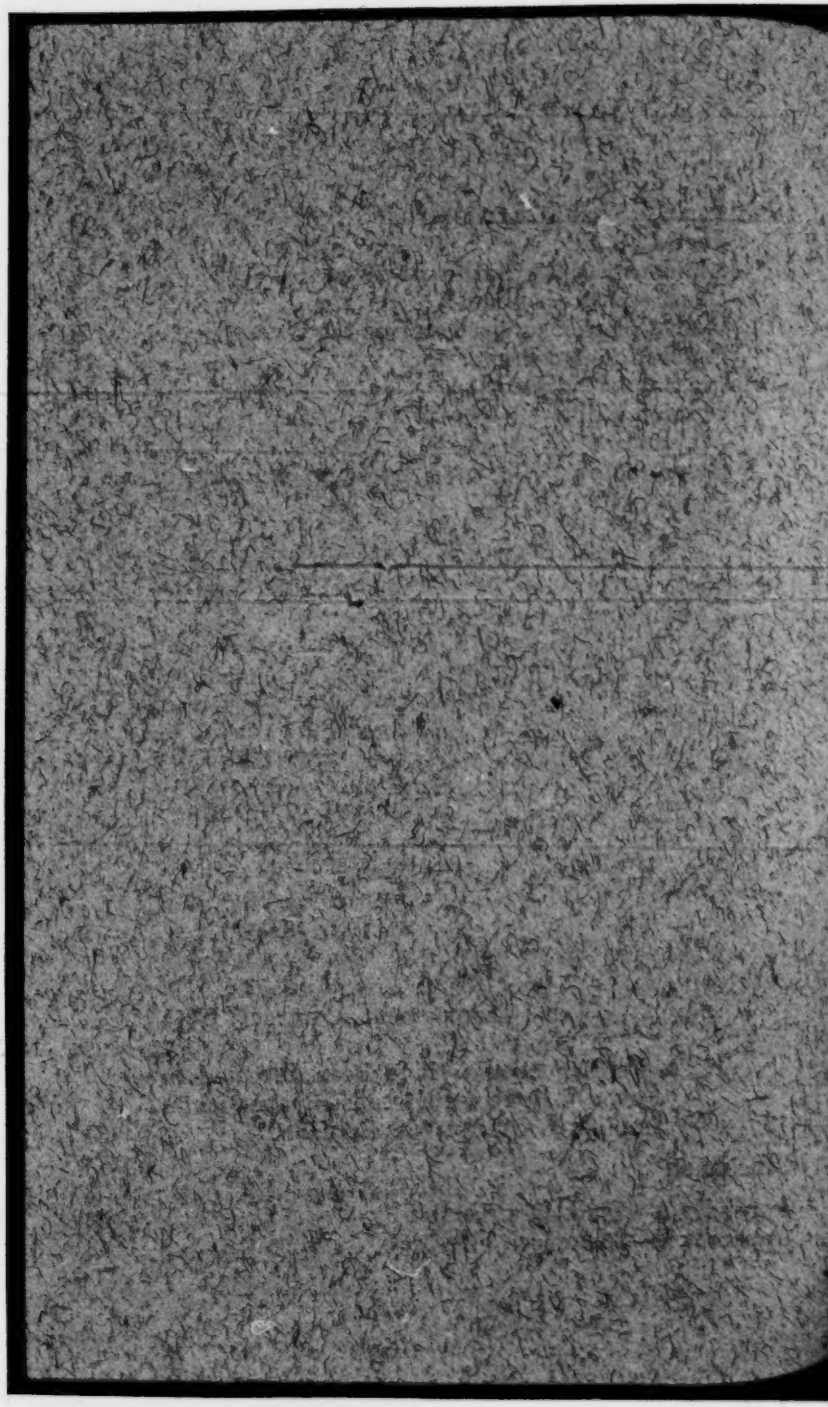

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The petitioner herein prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit, entered March 16, 1949 (R. 197), affirming a judgment in the sum of $166,491.40 in favor of the plaintiff-respondent in the United States District Court for the Southern District of New York (R. 177), entered on a directed verdict after a trial before a jury, and

an order of said District Court denying petitioner's motion for a new trial and for a directed verdict in favor of petitioner (R. 182-183). On April 5, 1949 the Court of Appeals entered an order denying rehearing but modifying its opinion (R. 208).

Jurisdiction

The jurisdiction of this Court is invoked under Section 1254 (1) of Title 28, United States Code.

Statement of the Matter Involved

This action was removed to the District Court on the ground of diversity of citizenship. Respondent brought the action, which was tried before a jury, on a written agreement (herein called "letter agreement"), executed and providing for performance in New York, by which, among other things, he agreed to assign to petitioner, a California corporation, his rights under an employment contract with S. Klein On The Square, Inc. (herein called "Klein") and petitioner agreed to pay him $200,000 (R. 49-50, 152). Petitioner had also, in a separate agreement (herein called the "securities agreement"), on the same day contracted to purchase the outstanding securities of the Klein corporation (R. 49-50, 151). The purchase price of the securities had been tentatively fixed prior to the commencement of negotiations with respect to the letter agreement (R. 103-104).

Petitioner defended against respondent's action on the grounds that it had agreed to purchase respondent's employment contract in order to relieve Klein of its obligations to respondent under that contract (R. 109); that respondent had expressly and impliedly warranted that his contract was not subject to unilateral termination by Klein, when the fact was that respondent, while serving as president of the corporation under the contract, had unlawfully converted to his own personal use $63,000 of Klein's funds

(which he subsequently returned) (R. 85, 87-89, 92, 98-100, 129-130, 137-139, 140, 175-176), and had defrauded Klein of a claim of $5,000 against himself by misrepresentations to the board of directors and the stockholders (R. 67, 73-75, 108, 128, 157, 169-171); and that these facts, unknown to Klein or petitioner until after the closing pursuant to the letter agreement (R. 108, 127-129, 130, 138), would have allowed Klein to terminate the employment contract without any cost to itself or petitioner.

A verdict having been directed in respondent's favor after the presentation of evidence by both parties, the Court of Appeals affirmed on the ground that petitioner's depredations as president were "technical irregularities," finding it "inconceivable that the Klein corporation would have tried to rescind the contract" on their account; interpreted the express oral warranty to mean only that Stone was surrendering a valuable contract which would not be rescinded by Klein; and that "So understood, the statement [i.e., the express warranty] was true, for, in assigning his contract, and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned" (R. 195-6). Respecting the defense of implied warranty the Court of Appeals agreed that "ordinarily, an assignor of a contract right makes an implied warranty 'that the right, as assigned, actually exists and is subject to no limitations or defenses other than those stated or apparent at the time of the assignment'—Restatement of Contracts, Sec. 175", but it held that no such warranty is to be implied where the assignment is taken not to exploit the right assigned, but to release the obligor from his duties (R. 196).

Questions Presented

1. Whether the direction of a verdict by a Federal Court constitutes a denial of trial by jury as guaranteed by the

Seventh Amendment and is erroneous under Rule 38 (a) of the Federal Rules of Civil Procedure—

(A) where on the issues of fact (i) there is substantial evidence in the record in support of the case of the opposing party; (ii) the jury could find for the opposing party without speculation; (iii) the Court rejects the testimony of witnesses testifying in support of the opposing party; (iv) the Court interprets a witness' own words, the witness having stated the substance of what he heard, and fails to give those words their ordinarily accepted meaning; and/or (v) the Court fails to make every reasonably possible inference in favor of the opposing party;

(B) where determination of the issues of fact depend upon a finding as to the purpose of the parties in entering into a contract and the interpretation thereof, and the Court makes its findings on the basis of the statements and acts of the parties from which conflicting inferences may be drawn and with respect to which there is conflicting evidence;

(C) where the issue is the interpretation of an oral express warranty which may be interpreted reasonably in a manner other than that adopted by the Court;

(D) on the record in this case.

2. Whether under New York law an oral warranty that a contract is "free from infirmities" means, as a matter of law, merely that as a practical matter such contract would not be rescinded.

3. Whether under New York law a warranty may not be implied with respect to a purchased item which is not intended to be exploited.

4. Whether under New York law the conversion of $63,000 of corporate funds, and corporate personalty and the fraudulent procuring of the write-off of $5,000 in per-

sonal charges on the corporate books, all by a director-officer constitutes merely "technical irregularities," or whether such acts create an infirmity in the employment contract which such officer-director had with such corporation.

5. Whether the District Court erred in refusing to grant petitioner's motion for a directed verdict based upon an implied warranty and the respondent's conversion of corporate funds which was subsequently discovered by petitioner and was admitted by respondent at the trial.

6. Whether a District Court, exercising diversity jurisdiction, may make an inference as a matter of law from specified facts, where such inference is not permitted by the law of the state in which the District Court sits and which governs the case.

7. Whether a District Court, exercising diversity jurisdiction, must leave to the jury an issue which would be so left by the law of the state in which the District Court sits and which governs the case.

Reasons Relied On for Granting the Writ

1. The United States Court of Appeals for the Second Circuit has affirmed a District Court judgment based on a directed verdict on grounds which seriously conflict with the decisions of this Court and of Courts of Appeal of other circuits construing the Seventh Amendment and the rules governing direction of verdicts.

(A) On testimony that the substance of respondent's oral warranty to petitioner was that his employment contract was valuable, valid and subsisting and free from infirmities (R. 105-6, 109, 115), the Court of Appeals found that respondent had only warranted that the contract would not, as a practical matter, be re-

scinded by Klein, his employer (R. 195). In so interpreting the warranty, the Court below either passed unfavorably on the credibility of the witness, which this Court has held it may not do, *Baltimore & O. R. Co.* v. *Groeger,* 266 U. S. 521, 524; *Gunning* v. *Cooley,* 281 U. S. 90, 94; *Tennant* v. *Peoria & Pekin Union R. Co.,* 321 U. S. 29, 35 *Lavender* v. *Kurn,* 327 U. S. 645, 652-653; *Ellis* v. *Union Pacific R. Co.,* 329 U. S. 649, 653, or failed to give the words used by the witness in his testimony their ordinarily accepted meaning. The jury would be free to find that the witness intended his words to convey their usual meaning, since this Court has held that where conflicting inferences may be drawn, the issue is one for the jury, *Ellis* v. *Union Pacific R. Co.,* 329 U. S. 649, 653; *Lavender* v. *Kurn,* 327 U. S. 645, 652-653; *Barreda* v. *Silsbee,* 21 How. (62 U. S.) 146, 167, and the probative value and weight of the evidence are also for the jury. *Baltimore & O. R. Co.* v. *Groeger,* 266 U. S. 521, 524; *Barreda* v. *Silsbee,* 21 How. (62 U. S.) 146, 167; *Barney* v. *Schneider,* 9 Wall. (76 U. S.) 248, 253; *Hickman* v. *Jones,* 76 U. S. 197, 201; *Gunning* v. *Cooley,* 281 U. S. 90, 94; also *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery,* 6th Cir., 74 F 463, 465 (Taft, C. J.).

(B) With respect to other findings, too, the Court below rejected the testimony favorable to petitioner's case, and made a choice among the conflicting inferences which could have been made therefrom. (See cases cited in preceding sub-paragraph.) Thus, the Court found that petitioner's purpose was to rid Klein, its prospective subsidiary, of respondent's employment contract without a lawsuit (R. 196-197), although there was testimony that petitioner purchased respondent's rights in reliance on his representations that the employment contract was free from infirmities (R. 105-106, 109, 115-6). The only basis for the Court's finding is that Klein was a prospective subsidiary of petitioner, and petitioner purchased respondent's rights under an employment contract with Klein. From this the jury would be as free to infer that petitioner purchased only

because it believed Klein could not otherwise terminate the contract.

(C) The Court below found that petitioner would have purchased respondent's rights even had it known Klein could terminate because it obtained from respondent a restrictive covenant and his consent to the sale of the securities (R. 196), the latter element having been inferred from the execution of the letter agreement and securities agreement on the same day. Where two contracts are executed the same day between the same parties, the fact may be, and a jury can conclude, that the two are separate. Moreover, there was testimony that one was not consideration for the other (R. 105). There was also testimony that petitioner did not desire the restrictive covenant and that the covenant was included in the letter agreement merely to accommodate respondent's tax purposes (R. 107-8).

(D) The Court below found that petitioner's purchase of the rights under the employment contract to enable Klein to terminate the contract, demonstrated an intent, as a matter of fact, that no warranty should be implied with respect to Klein's power to terminate the contract (R. 196). The contrary inference, being fully as reasonable, could have been made by the jury.

(E) Respondent, in his testimony, acknowledged converting $63,000 in corporate funds (R. 84, 87-9, 98-100, 130, 137-140, 175-6) and there was evidence that he fraudulently procured the write-off of $5,000 in personal charges on the corporate books (R. 67, 73-5, 108, 127-8, 157, 169-171), and converted some corporate personalty (R. 94-5). The Court of Appeals found that these acts were "technical irregularities" for which it was "inconceivable" that Klein would terminate the contract (R. 196). First, there was not a shred of evidence from which the Court could have found what Klein would have done and, even assuming such evidence, its evaluation would have been within the exclusive province of the jury. Second, the light view the Court took of respondent's misconduct can

only be due to its acceptance of respondent's testimony that he revealed the facts to everyone and obtained the informal consent of all, and its rejection of the testimony supporting petitioner's case that neither Klein nor petitioner knew of respondent's misconduct (R. 108, 127-130, 138). Since all of these findings rest upon a choice of possible inferences on conflicting testimony, the Court of Appeals erred in failing to draw all reasonably possible inferences in favor of petitioner on respondent's motion for a directed verdict. *Gunning* v. *Cooley*, 281 U. S. 90, 94; *Galloway* v. *United States*, 319 U. S. 372, 395.

(F) Not only did the Court of Appeals reject testimony favorable to petitioner and make a choice among conflicting inferences on its finding with respect to the intent of the parties, but in relying upon circumstances dehors the agreement in making its finding, it violated the principle established in *Rankin* v. *Fidelity Ins. T. & S. C. Co.*, 189 U. S. 242, 252, which requires that such an issue be left to the jury.

(G) Returning to the oral warranty, and assuming, *arguendo*, that the Court of Appeals reasoned that it had the actual wording thereof before it rather than the witness' interpretation of those words, the Court gave the wording of the warranty an extraordinary meaning which could only have been given it by the jury under the Ninth Circuit's decision in *Butte & B. Consol. Mining Co.* v. *Montana Ore Purchasing Co.*, 121 F. 524, 528, Since the accepted meaning was a more probable indication of the intent of the parties, the warranty was ambiguous if we assume that the extraordinary meaning given by the Court was a possible one, and the issue of interpretation was for the jury under the decisions in *Luse* v. *Martin*, 8th Cir., 215 F. 28; *Arkwright Mills* v. *Aultman & Taylor Machinery Co.*, 1st Cir., 145 F. 783; see *Kennedy* v. *National Tube Co.*, 3rd Cir., 255 F. 1, 3. Moreover, in making its interpretation, the Court relied on facts dehors the wording of the warranty, and was there-

fore required by the decisions of this Court to leave the issue to the jury. *Etting* v. *Bank of United States*, 24 U. S. 59, 75; *Barreda* v. *Silsbee*, 21 How. (62 U. S.) 146, 167; *West* v. *Smith*, 101 U. S. 263. See also *United States Steel Products Co.* v. *Poole-Dean Co.*, 9th Cir., 245 F. 533, 537; *Sinclair Refining Co.* v. *Refiners Oil Co.*, 6th Cir., 75 F. (2d) 851, 852; *International Glass Co.* v. *Krause*, 3rd Cir., 282 F. 206, 208.

(H) The Court sustained the direction of a verdict against petitioner although there was at the very least substantial evidence tending to support petitioner's case, and the jury could have found for petitioner without speculation. The issues were required to be left to the jury under the decisions of this Court. *Gardner* v. *Michigan Central R. Co.*, 150 U. S. 349, 361; *Galloway* v. *United States*, 319 U. S. 372, 395; *Tennant* v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 32-33; Also *Garrison* v. *United States*, 4th Cir., 62 F. (2d) 41, 42; *Travelers Ins. Co.* v. *Randolph*, 6th Cir., 78 F. 754, 759-760 (Mr. Justice Harlan); *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery*, 74 F. 463, 465, 470, 473, 475, 477 (Judge, later Mr. Justice, Lurton); see *Felton* v. *Spiro*, 78 F. 576, 582 (Judge, later Mr. Chief Justice, Taft).

Moreover, similar departures from established principles governing the direction of verdicts, although not as extreme, have occurred in the Second Circuit in a sufficient number of cases involving issues other than negligence as to urgently commend to this Court's discretion the exercise of its power of supervision. Instances of such departures are to be found in: *Benz* v. *Celeste Fur Dyeing & Dressing Corp.*, 156 F. (2d) 510; *Wasilowski* v. *Park Bridge Corp.*, 156 F. (2d) 612; *McCarney* v. *Scott*, 146 F. (2d) 624; *Henjes* v. *Aetna Ins. Co.*, 132 F. (2d) 715, cert. denied 319 U. S. 760; *Bush* v. *Order of United Commercial Travelers*, 124 F. (2d) 528. And compare the unfavorable comments on jury verdicts of the writer of the opinion below in the instant case appearing in *Skidmore* v.

Baltimore & O. R. Co., 167 F (2d) 54, cert. denied 335 U. S. 816; also *Roth* v. *Goldman*, 172 F. (2d) 788, 795, n. 30.

2. The United States Court of Appeals for the Second Circuit, in affirming a judgment of the District Court entered after a directed verdict, decided the following important questions of local law in a manner in conflict with applicable local decisions.

(A) The Court of Appeals held that where two contracts are signed the same day and the two parties are parties to both contracts, the signing of one is consideration for the signing of the other although the contracts do not so provide and although there is no testimony to that effect. The decisions of the New York courts are to the contrary. *Topken, Loring & Schwartz, Inc.* v. *Schwartz*, 249 N. Y. 206, 208, 211; *Petze* v. *Leary*, 117 App. Div. 829.

(B) The Court of Appeals held that a warranty may not be implied with respect to an item not purchased for exploitation. The decisions of the New York courts are to the contrary. *Carleton* v. *Lombard, Ayers & Co.*, 149 N. Y. 137, 146; *Becket* v. *Smithers*, 50 N. Y. Super. Ct. (18 Jones & Spencer) 378, 385.

(C) The Court of Appeals held that the following acts by a director-officer of a corporation having an employment contract with said corporation constitute only "technical irregularities": converting corporate funds in the aggregate sum of $63,000 and some corporate personalty; and fraudulently procuring the write-off from the corporate books of personal charges aggregating approximately $5,000. The New York courts have held that such acts, and less serious acts, constitute grounds for which an employer may terminate an employment contract. *Gray* v. *Shepard*, 147 N. Y. 177, *Lamdin* v. *Broadway Surface Advertising Corp.*, 272 N. Y. 133; *Hutchinson* v. *Washburn*, 80 App. Div. 367; *Katz* v. *Goodman*, 176 N. Y. Supp. 488.

3. The United States Court of Appeals for the Second Circuit, in affirming a judgment of the District Court, entered after a directed verdict, has rendered a decision in conflict with that of the United States Court of Appeals for the Sixth Circuit in *Motor Wheel Corp.* v. *Rubsam Corp.*, 92 F. (2d) 129, cert. denied 304 U. S. 560. The former court held an issue to be one of law for the court, although under the applicable local law the issue was one for the jury. Under the Sixth Circuit decision such an issue should be left to the jury. Specifically, the Second Circuit:

(A) held that the proper interpretation of an oral warranty is for the court although a different interpretation would be, at least, as reasonable; whereas, under the New York decisions, the interpretation would constitute an issue for the jury. *Debany* v. *Rosenthal*, 152 N. Y. Supp. 1043;

(B) made inferences from facts from which conflicting inferences could just as reasonably have been drawn. Under New York law, the making of such inferences would constitute an issue for the jury. *Henry & Co.* v. *Talcott*, 175 N. Y. 385, 393.

Conclusion and Prayer

For the reasons stated it is respectfully submitted that this petition to review the judgment of the United States Court of Appeals for the Second Circuit should be granted.

DAVID MACKAY,
Counsel for Petitioner.

EMANUEL L. GORDON,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinion Below

The District Court wrote no opinion. The opinion of the United States Court of Appeals for the Second Circuit (p. 44, infra) as modified (R. 193, 208) is reported at 173 F. (2d) 135 [1]

Jurisdiction

The basis for this Court's jurisdiction is set forth in the Petition at page 2.

Errors Below Relied upon Here and Summary of Argument

We respectfully refer the Court to the Reasons Relied on for Granting the Writ set forth in our Petition, at which place the errors below relied upon here, together with a summary of our argument, are set forth in such form as to make further introductory exposition here merely repetitious.

I

Petitioner Has Been Denied a Trial by Jury as Guaranteed by the Seventh Amendment

Over-liberal use of the directed verdict can make serious incursions into the constitutional right to trial by jury in civil actions at law (*Lavender* v. *Kurn*, 327 U. S. 645; *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649). Jury trial cannot be saved from such incursions unless this Court is willing, as it has been in the past, to consider, in individual cases,

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[1] The modified opinion as reported varies from the certified text in that it erroneously includes in the second paragraph the words "if we regard it as sufficiently proved."

whether there was enough evidence on the side of the losing party to require the case to go to the jury. The departures in the instant case from established principles relating to direction of verdicts are, we submit, so extreme as to require the exercise of this Court's power of supervision, "for any seeming curtailment of the right to trial by jury should be scrutinized with the utmost care." *Dimick* v. *Schiedt*, 293 U. S. 474, 486; *Bollenbach* v. *United States*, 326 U. S. 607, 615; see Mr. Justice Murphy dissenting in *Galloway* v. *United States*, 319 U. S. 372, 396, 407.

This was a diversity suit, and consequently no verdict should have been directed if either the Seventh Amendment or applicable local law required it to be submitted to the jury. *Slocum* v. *New York L. Ins. Co.*, 228 U. S. 364, 376-377; *Motor Wheel Corp.* v. *Rubsam Corp.*, 9th Cir., 92 F. (2d) 129, cert. den. 304 U. S. 560. The decisions of this Court and of other Circuits interpreting the requirements of the Seventh Amendment, as well as applicable New York law, required many of the issues determined by the Courts below to be submitted to the jury.

This Court has held that "a case should not be withdrawn from the jury unless the conclusion follows as a matter of law that no recovery can be had upon any view which can properly be taken of the facts the evidence tends to establish." *Gardner* v. *Michigan Central R. Co.*, 150 U. S. 349, 361. *Hickman* v. *Jones*, 9 Wall. (76 U. S.) 197, 201; *Iasige* v. *Brown*, 17 How. (58 U. S.) 183, 196; *Barreda* v. *Silsbee*, 21 How. (62 U. S.) 146. While there are cases which speak in terms of authorizing a directed verdict for one party if there is insufficient evidence upon which a jury may properly find for the opposing party (*Coughlan* v. *Bigelow*, 164 U. S. 301, 309), still, in considered and exhaustive opinions by the United States Court of Appeals for the Sixth Circuit, written by Mr. Justice Harlan, Judge (later Mr. Chief Justice)

Taft, and Judge (later Mr. Justice) Lurton, it has been held that a verdict may not be directed for one party merely because a verdict in favor of the opponent should be set aside by the court. *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery*, 74 F. 463, 465, 470, 473, 475, 477; *Travelers Ins. Co.* v. *Randolph*, 78 F. 754, 759-760; See *Felton* v. *Spiro*, 78 F. 576, 582. *Accord: Garrison* v. *United States*, 4th Cir., 62 F. (2d) 41, 42. The view expressed in these circuits has been recently affirmed by decisions of this Court. In *Galloway* v. *United States*, 319 U. S. 372, 395, the test is stated as follows:

> "Finally, the objection appears to be directed generally at the standards of proof judges have required for submission of evidence to the jury. But standards, contrary to the objection's assumption, cannot be framed wholesale for the great variety of situations in respect to which the question arises. Nor is the matter greatly aided by substituting one general formula for another. It hardly affords help to insist upon 'substantial evidence' rather than 'some evidence' or 'any evidence' or vice versa. The matter is essentially one to be worked out in particular situations and for particular types of cases. Whatever may be the general formulation, the essential requirement is that mere speculation be not allowed to do duty for probative facts, after making due allowance for all reasonably possible inferences favoring the party whose case is attacked."

Accord: Tennant v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 32-33, 35.

It will be demonstrated below that in the instant case petitioner had made more than a sufficient showing to entitle it to go to the jury, and that the Court below reached the contrary conclusion by making a determination with respect to the credibility of petitioner's witnesses, by rejecting the testimony given and by resolving conflicting inferences in favor of respondent.

A. PETITIONER'S PURPOSE WAS TO RELIEVE KLEIN OF THE BURDEN OF AN OBLIGATION WHICH IT COULD NOT OTHERWISE TERMINATE, AND PETITIONER OBTAINED AN EXPRESS WARRANTY THAT THE EMPLOYMENT CONTRACT WAS FREE FROM INFIRMITIES.

Petitioner contended that its agreement to pay $200,000 for the purpose of enabling Klein to terminate the employment contract was premised on the assumption that that purpose could not be achieved free of charge—that Klein did not already have a right to terminate the contract with respondent for which petitioner was agreeing to pay $200,000. It supported that contention by testimony that respondent had expressly warranted that his contract was "a valid and subsisting one, free from infirmities", and by the implied warranty which the Court below conceded is "ordinarily" made by the assignor of a contract right—"that the right as assigned . . . is subject to no limitations or defenses other than those stated or apparent at the time of the assignment" (R. 196). The evidence establishing the facts will be discussed after the analysis of their legal significance.

(1) *The Legal Significance of the Facts*

If there was a breach of contract by respondent, petitioner could terminate any further performance on its part and recover damages in addition. *Breiterman* v. *Breiterman*, 239 App. Div. 709; *Hurst* v. *Trow Printing & Bookbinding Co.*, 2 Misc. 361, aff'd 142 N. Y. 637; *Cummings* v. *Standard Harrow Co.*, 55 Misc. 601, aff'd 124 App. Div. 915, aff'd 195 N. Y. 513

There are a number of grounds upon which rescission is available. If respondent had made knowingly false statements upon which petitioner relied, petitioner is entitled to rescission, *Adams* v. *Gillig*, 131 App. Div. 494, aff'd 199

N. Y. 314, even though no damage appears, *Downey* v *Mallison*, 232 App. Div. 703. Rescission may also be had if respondent made an innocent misrepresentation of a material fact upon which petitioner relied. *Bloomquist* v. *Farson*, 222 N. Y. 375, 380; or if there was a mutual mistake of fact, *Webb* v. *Odell*, 49 N. Y. 583, 585; *Flynn* v. *Smith*, 111 App. Div. 870, 873; or even if *petitioner* made a unilateral mistake of a material fact. *Rosenblum* v. *Manufacturers Trust Co.*, 270 N. Y. 79, 85; *In re Clark's Estate*, 233 App. Div. 487; *Batto* v. *Westmoreland Realty Co. Inc.*, 231 App. Div. 103; *Seidman* v. *N. Y. Life Ins. Co.*, 162 Misc. 560.

Rescission may also be had for a partial breach of contract or partial failure of consideration "which strongly tend[s] to defeat the object of the parties in making the contract." *Callanan* v. *K. A. C. & L. C. R. R. Co.*, 199 N. Y. 268, 284-285; *Clark Contracting Co.* v. *City of New York*, 229 N. Y. 413; *Fossume* v. *Requa*, 218 N. Y. 339; *Webb* v. *Odell*, 49 N. Y. 583, 585; *Mindheim* v. *Mindheim*, 21 N. Y. S. (2d) 372.

Under New York law a party seeking rescission need not tender back the benefits received, but the court may make appropriate provision therefor in its judgment. N. Y. C.P.A. Sec. 112-g (see p. 43, *infra*). It is immaterial whether petitioner is entitled to termination or rescission. Under rescission, petitioner would obtain the $50,000 which it paid respondent but would have to restore to respondent the value of the restrictive covenant.[2] If damages were awarded to petitioner based upon termination, the measure thereof would yield the same result as under rescission. Petitioner sought to acquire certain rights under a contract not terminable by Klein; but the employment contract involved in the deal *was* terminable by Klein. Petitioner's damages consist of what it paid respondent less the value

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[2] See footnote, p. 18, infra.

of what was received, the restrictive covenant. *Nelson* v. *Hatch*, 70 App. Div. 206, aff'd 174 N. Y. 546.

Petitioner bargained for rights under a contract which Klein could not unilaterally terminate, in order to free Klein of the burden of the contract. The failure of consideration occurred because, although Klein was freed of that obligation, it could have been freed without making any payment. *Tams-Witmark Music Library, Inc.*, v. *New Opera Co.*, 298 N. Y. 163. The employment contract had been terminated before the facts were discovered, and there was nothing further for petitioner to do in order to terminate or rescind its agreement.

It may be pointed out that the same result would have followed even if petitioner had acquired the rights under the employment contract in order to exploit them. In that case, as assignee, petitioner would take respondent's rights subject to the same defenses which Klein would have had against respondent. *Matter of Nunez*, 226 N. Y. 246. Klein would not be estopped to raise the defenses because it first learned of them after petitioner's closing with respondent. *Union Trust Co. of Rochester* v. *Allen*, 239 App. Div. 661. Petitioner could recognize the validity of Klein's defenses and recover from respondent upon proof thereof. *McConkey Realty Corp.* v. *Wildermuth*, 214 App. Div. 395, 397; *National Metal Edge Box Co.* v. *Gotham*, 125 App. Div. 101. Moreover, petitioner's bargain was with respondent and was for a certain kind of right. If those rights were not of the type bargained for, there was a failure of consideration without regard to the position Klein might take. *Nelson* v. *Hatch*, 70 App. Div. 206, 211-212, aff'd 174 N. Y. 546.

Accordingly, petitioner's case should have been sent to the jury if there was substantial evidence tending to prove that petitioner bargained for rights under a contract which Klein could not unilaterally terminate and that bargain constituted the essence of the agreement between petitioner

and respondent; *or* that petitioner entered into the agreement under the mistaken belief that the employment agreement was not subject to termination by Klein, and that belief was material; *or* that respondent innocently misrepresented that the employment contract was not subject to termination by Klein, and that misrepresentation was material and petitioner relied thereon; *or* that petitioner secured an express oral warranty that the employment contract was not subject to termination by Klein and obtaining rights under that employment contract constituted the essence of the petitioner's agreement with respondent. We shall now demonstrate that the requisite evidence is present in the record.

(2) *The Object of the Contract and the Warranties*

On January 27, 1946, Mr. Diamond, on behalf of petitioner, tentatively reached an agreement with the Klein officials for the purchase of its outstanding securities (R. 103-104). The following day, Diamond negotiated with respondent, himself an attorney (R. 44), for the acquisition by petitioner of the latter's rights under an employment contract with Klein.[3] That employment contract, executed April 5, 1944, provided for the employment of respondent by Klein until April 14, 1949 at a salary of $25,000 (later increased to $30,000), plus 5% of the annual net profits, for serving as president of Klein and executive director of the store (R. 11, 21, 22, 46-48, 150). For the fiscal year ended September 30, 1944, respondent's share of the profits under the employment contract was $4,309.96 (R. 142).

[3] The letter agreement resulting therefrom provided that in the event of a closing under the securities agreement, respondent would assign to petitioner his rights under the employment contract, resign as an officer and director of Klein, and restrict his business activities as specified. Petitioner agreed to pay $50,000 down and $150,000 in installments subject to acceleration upon default (R. 152). The latter two promises are discussed at pp. 27-29, infra.

Respondent offered to sell his rights under the employment contract to petitioner for $200,000 (R. 105). Diamond testified that respondent had represented to him, and that he had relied on the representation, that the employment contract was a valuable contract which had some time to run, and which provided for a participation in profits in addition to a fixed salary; and that respondent further represented, in substance, that the employment contract was a valid and subsisting contract, free from infirmities (R. 105-106, 109, 115). On cross-examination, the following appears in the record (R. 115-116):

> "Q. Now you told Mr. Mackay on direct examination that among other things Mr. Stone said to you, 'I have a valid and subsisting contract, free from infirmities.' You said that, didn't you? A. Well, in substance. I am not sure those were the words, but that was the meaning of what was said.
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> • • • • • • •
>
> Q. When you said on direct examination that Mr. Stone said to you that he had a valid and subsisting contract free from infirmities, you did not intend to convey to the jury that those were his exact words, did you? A. I did not, no, sir.
>
> Q. In other words, what you meant was that was your understanding of what Mr. Stone was saying to you, is that it? A. That is right.
>
> Q. You don't now contend that Mr. Stone said to you 'My contract is free from infirmities'—A. Well, if he did not——
>
> Q. In that exact language? A. Well, if he did not, I would not insist that is what he said."

That the substance rather than the exact words of respondent was given does not prevent the establishment of an express warranty. *John A. Crowley Co.* v. *Clark Equipment Co.*, 2d Cir., 263 F. 58; *Petty* v. *Fish*, 30 Misc. 828. Moreover, the testimony had been admitted and remained

in the record without objection, and therefore must be considered as evidence like any other probative facts, and the Court of Appeals so recognized when it revised its opinion upon denial of the petition for rehearing (R. 201, 208; see p. 44, *infra*). *Schlemmer* v. *Buffalo, etc., Ry.*, 205 U. S. 1, 9; *Diaz* v. *U. S.* 223 U. S. 442, 450; *Rowland* v. *Boyle*, 244 U. S. 106, 108; *Spiller* v. *Atchison, etc., Ry.*, 253 U. S. 117, 130; *Opp Cotton Mills, Inc.* v. *Administrator*, 312 U S. 126, 155; *Gross* v. *R. & S. Outfitting Co.*, 140 N. Y. Supp. 115. Respondent, it is true, denied making any representations, but that conflict merely raised an issue of credibility which the Court could not take from the jury. *Baltimore & O. R. Co.* v. *Groeger*, 266 U. S. 521, 524; *Gunning* v. *Cooley*, 281 U. S. 90, 94; *Tennant* v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 35; *Lavender* v. *Kurn*, 327 U. S. 645, 652-653; *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649, 653; *Garrison* v. *U. S.*, 4th Cir. 62 F. (2d) 41, 42; *Howard* v. *Louisiana & A. Ry. Co.*, 5th Cir. 49 F. (2d) 571.

Under New York law, "any representation" made by the seller "of the state of the thing sold, at the time of the sale will amount to a warranty" (*Chapman* v. *Murch*, 19 Johns (N.Y. 290)). One of the important tests in determining whether a representation is one of fact or of opinion is the relative knowledge of the parties concerning the subject matter of the statement. *Titus* v. *Poole*, 145 N. Y. 414, 426; *Coleman* v. *Simpson, Hendee & Co.*, 162 App. Div. 335, 336. In view of respondent's expert status (he is himself an attorney (R. 44)) and his monopoly over the information relating to his misconduct, there is no question but that his representation was one of fact. At the very least, whether the representations constituted a warranty was an issue for the jury.[4] *Hercules Powder Co.* v. *Rich*,

[4] In any event, since the representation was material and petitioner relied thereon, petitioner would be entitled to rescind if it was false.

8th Cir., 3 F(2d) 12. Although the Court below originally found no express warranty (see p. 44, infra), it subsequently altered its opinion to assume that such a warranty was given (R. 208). Our objection relates to the finding with respect to the content of the warranty.

The Court of Appeals stated (R. 195-196, 208):

> "We shall, however, regard the express warranty as given. But it appears to us to mean only that Stone was surrendering a valuable contract which would not be rescinded by Klein. So understood, the statement was true, for, in assigning his contract, and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned. His contract was a good one, in the practical sense that Stone's relationship with Klein company was such that he could expect employment at the contractual rate for the duration of the contract term. It is inconceivable that the Klein corporation would have tried to rescind the contract on account of the technical irregularities alleged."

But Diamond, in stating the substance of what had been represented to him by respondent, testified that he had been told that the employment contract was free from "infirmities". That testimony the Court below completely ignored in its opinion.[5] If the Court was thus expressing its view of the credibility of the witness it was improper under the authorities cited above. If, however, the Court thought that it was accepting that testimony, as it must, but was interpreting it to mean only that Diamond was reporting that he had been told by respondent that "the Klein company had never questioned" the contract, then the Court was rejecting the ordinary meaning of the words used by the witness. It was also passing over testimony

[5] We pass over the Court's interpretation of the word "valuable" as meaning subjectively valuable to respondent—an interpretation entirely out of context in the light of respondent's superior knowledge.

that Klein was then not aware that respondent had abused his trust, and that it consequently had a right to terminate his contract. (See Point I, B, infra).

An "infirmity" is a defect or a weakness. The first and obvious meaning, and the one the jury would be clearly justified in giving to the testimony of the witness, is that Diamond had been told, in substance, that the employment agreement could not be unilaterally terminated by Klein prior to its expiration date.

Moreover, the meaning ascribed by the Court yields absurd results. Petitioner was acquiring control of Klein. Respondent knew of the securities agreement since he was a party thereto, and, as will be shown below, also knew that the employment contract was subject to termination because of his own prior misconduct. Surely he was not, under these circumstances, warranting to the party about to obtain control of Klein that the employment contract "would not be rescinded by Klein" (as the Court below interpreted the warranty). Respondent could not possibly know what petitioner would do when it controlled Klein and petitioner would not be interested in being told what it *would* do. Petitioner only desired to know what it *could* do.

The probative value and inferences to be drawn from the testimony were issues for the jury. *Baltimore & O. R. Co.* v. *Groeger*, 266 U. S. 521, 524; *Barreda* v. *Silsbee*, 62 U. S. (21 How.) 146, 167. On a motion for a directed verdict the court must make "all reasonably possible inferences favoring" the opposing side. The Court's failure to ascribe to Diamond's testimony its obvious meaning leads inevitably to the conclusion that the Court was weighing the evidence and rejecting the veracity of the witness, or his understanding, or the accuracy of his report, all being within the sole competence of the jury.

We may proceed further and assume, *arguendo*, that respondent actually spoke the words used by Diamond in

his summary. Still, the Court below erred in giving to the wording of the warranty a meaning not ordinarily accepted. If the possibility exists that such an extraordinary meaning was intended, the issue of interpretation is for the jury. *Butte & B. Consol. Min. Co.* v. *Montana Ore Purchasing Co.*, 9th Cir., 121 F. 524, 528. Moreover, it has been held that where a contract is partly written and partly oral, the interpretation thereof constitutes an issue for the jury. *United States Steel Products Co.* v. *Poole-Dean Co.*, 9th Cir., 245 F. 533, 537; *Hoffman* v. *American Mills Co.*, 2d Cir., 288 F. 768, 772, cert. denied 263 U. S. 701. If the extraordinary meaning is a possible interpretation, the accepted one is even more clearly so. The warranty was thus rendered ambiguous and, for this reason too, its interpretation was for the jury. *Arkwright Mills* v. *Aultman & Taylor Machinery Co.*, 1st Cir., 145 F. 783; *Luse* v. *Martin*, 8th Cir., 215 F. 28; see *Kennedy* v. *National Tube Co.*, 3rd Cir., 255 F. 1, 3; *Debany* v. *Rosenthal*, 152 N. Y. Supp. 1043.

It should be further noted that in its original opinion (p. 45, infra) the Court below described Diamond's testimony as "vague" with respect to the warranty.[6] If the Court so believed, that was all the more reason to refer the issue of interpretation to the jury.

As will be discussed under Point II, there was also an implied warranty that the employment contract was not subject to unilateral termination by Klein. Entirely apart from the express warranty, this should have barred the direction of a verdict against petitioner. As appears in Point II, the Court of Appeals erred in holding that a

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[6] The Court utilized the supposed vagueness as a ground for refusing to find that an express warranty had been given. In its petition for rehearing, petitioner argued that Diamond's testimony could mean only that the employment contract was not subject to termination by Klein, and hence was not vague (R. 202). In its modified opinion the Court withdrew the description "vague".

warranty may not be implied with respect to an item not purchased for exploitation. At this point we note that the Court below found "on the facts" that no implied warranty existed. It said an implied warranty exists "where the facts do not show a contrary intention. Assuming, *arguendo*, that the contract right here was subject to a defense which was not apparent, we think the facts disclose such a contrary intention, since defendant did not intend to exploit the contract" (R. 198). If, as the Court held, the issue is one of fact under New York law, then the jury would be free to draw an inference contrary to that drawn by the Court. Petitioner sought to enable Klein to terminate the employment contract, and the purchase of respondent's rights for $200,000 would have been unnecessary if Klein could unilaterally terminate them.

Diamond also testified that he had relied upon the foregoing representations made to him by respondent (R. 109). The inescapable inference from such testimony, and certainly one that the jury could clearly have entertained, is that petitioner, had it known of the infirmities in the employment agreement, would not have agreed to pay respondent anything, but would have effected the termination of the employment contract when it acquired control of Klein. From the testimony with respect to the representations and reliance, the inference was clearly permissible that petitioner's purpose was to obtain, and it bargained to obtain, rights under an employment contract which was not subject to unilateral termination by Klein. If the contrary inferences made by the Court below were logically permissible, they could be made only by the jury within whose sole competence lies the choice among conflicting inferences, even from the undisputed facts and under both Federal and State cases. *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649, 663; *Henry & Co.* v. *Talcott*, 175 N. Y. 385, 393. And where the purposes and objects of the parties

must perforce rest upon all the circumstances of the transaction, beyond the mere language of the contract, the issue must be referred to the jury. *Rankin* v. *Fidelity Ins. T. & S. D. Co.*, 189 U. S. 242, 252; *Ohio & Michigan Coal Co.* v. *Clarkson Coal & Dock Co.*, 6th Cir., 266 F. 189, 192.

The Court below found that petitioner's object was to get rid of respondent without a lawsuit or dispute (R. 196-197) notwithstanding that there is no support whatever for such a finding in the record. The Court arrives at that conclusion relying on two facts: (1) that petitioner had entered into another contract to purchase the Klein securities, and (2) that petitioner entered into the letter agreement with respondent to purchase respondent's rights under the employment contract. The conclusion is inconsistent with Diamond's testimony and ignores the sheer magnitude of the $200,000 purchase price as compared with what respondent was to receive under the employment contract itself. Moreover, the conclusion even without these contradictory facts is based on sheer speculation. The Court below does not have the expertise of an administrative agency in the field of purchasing control of a corporation which might be pointed to in support of such an inference. Cf. *S E C* v. *Chenery Corp.*, 332 U. S. 194. If getting rid of respondent without a lawsuit was not petitioner's object, and Klein could have terminated the employment contract with respondent, there was a failure of consideration. The fact that respondent left his employment without a dispute or lawsuit does not constitute consideration if petitioner did not bargain for it. *Tams-Witmark Music Library* v. *New Opera Co.*, 298 N. Y. 163.

The Court below concluded that petitioner would not have altered its bargain had it known the true facts (R. 196). This determination rests in part upon the premise, already shown to be erroneous, that petitioner was interested only in avoiding a lawsuit. However, the Court also relied for

its conclusion on the theory that petitioner obtained other benefits, the negative covenant on the part of respondent and his consent to the sale of the Klein securities (R. 196). There is nothing in the record to show that of these supposed other benefits, the former played any significant role or that the latter constituted any part of the letter agreement.

Negotiations had been pending for the purchase by petitioner of the Klein securities. On January 27, 1946, at a conference among Handmacher, Schwartz and respondent representing Klein, and Diamond representing petitioner, it was tentatively agreed that the securities of Klein would be sold to petitioner for $2,500,000 (R. 103-104). Thus, the securities agreement had already been negotiated when, on January 28, 1946, the respondent negotiated the letter agreement with Diamond for the sale of respondent's rights under the employment contract with Klein (R. 104). Both agreements were executed on February 2, 1946 (R. 49-50, 151).

During the negotiations on the letter agreement. Diamond testified that he had informed respondent that petitioner would not give respondent anything more for his stock than the other stockholders were receiving, and respondent had agreed to negotiate on that basis (R. 105). Thus, the finding of the Court below that respondent's consent to the sale of the stock (which was one of the rights attaching to the stock) constituted part of the consideration for the letter agreement was expressly negatived by testimony which the Court was required to accept on a motion for a directed verdict. Moreover, respondent, who testified at the trial, made no claim to the contrary. Indeed, respondent had a fiduciary obligation to the other security holders of Klein not to obtain more for his stock than they obtained for theirs. Hence, the only basis for the Court's finding that respondent sought to violate his fiduciary obligation rests

upon the fact that the securities and letter agreements were executed on the same day. The "reasonably possible inference" in favor of petitioner from the fact of execution on the same day is certainly not that one agreement constitutes consideration for the other but that the two are separate and distinct.

Moreover, the Court's finding is in direct conflict with the law of New York. In *Petze* v. *Leary*, 117 App. Div. 829, it was alleged that an employment contract had been made between plaintiff and a corporation of which defendant was an officer and stockholder. Simultaneously, plaintiff and defendant executed an agreement pursuant to which defendant agreed to give the plaintiff additional consideration if plaintiff carried out his contract with the corporation. The Court held that it could not be inferred from these facts that the execution of the contract with the corporation constituted part of the consideration furnished by plaintiff to defendant. *Accord: Topken, Loring & Schwartz, Inc.* v. *Schwartz*, 249 N. Y. 206, 208, 211.

The second item of additional consideration mentioned by the Court below was the negative covenant of respondent. In this instance the Court's unwarranted rejection of Diamond's testimony is clear. The securities agreement provided that for a period of 21 years none of the officers, directors, debenture holders or stockholders of Klein (including respondent) would, under the name "Klein" or an imitation or simulation thereof, engage in or become interested in any capacity in a business similar to or competitive with the business conducted by Klein (par. 1(n), R. 49, 151). Petitioner's object was made clearer when it consented to a clarification thereof on February 9, 1946 affirmatively permitting the restricted persons (including respondent) to engage in a competitive business provided it was not under the "Klein" name (R. 55-56, 165-166). Diamond testified that after he had agreed to a purchase

price of $200,000 for respondent's rights under the employment contract, respondent came to him and requested the inclusion of a restrictive covenant on his part so that he could claim that the proceeds of the sale constituted a capital gain (R. 107). Diamond informed respondent that although petitioner was not interested in obtaining a restrictive covenant barring him from engaging in a competitive business, it had no objections to respondent's including such a provision (R. 107-108).[7] In the face of this testimony it is difficult to see how, on a motion for a directed verdict against petitioner, the Court below could find that petitioner would not have altered its bargain had it known of the infirmities of the employment contract because it desired the restrictive covenant. It may be that the written agreement cannot be varied by parol to eliminate the restrictive covenant as technical consideration flowing to petitioner. However, "the consideration of a written instrument is always open to inquiry and a party may show that the design and object of the agreement was different from what the language, if alone considered, would indicate". *Baird* v. *Baird*, 145 N. Y. 659, 664; *Hutchison* v. *Ross*, 262 N. Y. 381, 398; *Van Kamen* v. *Roes*, 20 N. Y. Supp. 548, aff'd 144 N. Y. 685; *Smith* v. *Dotterweich*, 200 N. Y. 299, 305; *International Assets Corp.* v. *Axelrod*, 245 App. Div. 300; *O'Neill Supply Co.* v. *Petroleum H. & P. Co.*, 280 N. Y. 50, 55-56; *Fire Insurance Ass'n.* v. *Wickham*, 141 U. S. 564.

We proceed to negative another item of possible consideration, the third (and last) promise contained in the letter agreement. In the event of a closing under the securities agreement, respondent promised to resign as an officer and director of Klein and of its subsidiaries (R. 49-

[7] The covenant provides that for a period of six years respondent would refrain from assuming an executive position in a ladies apparel department store in Manhattan (R. 152).

50, 152). However, in the securities agreement, respondent had agreed to deliver his resignation as an officer and director of Klein and of its subsidiaries at the closing under that agreement (par. 4(a), R. 49, 151). The promise in the letter agreement would thus become effective only in the event that respondent had already resigned. Even if the two agreements were executed simultaneously, the promise to resign in the letter agreement would not constitute consideration. *Petze* v. *Leary*, 117 App. Div. 829.

Since the promise to resign does not constitute consideration, and petitioner neither desired nor bargained for the restrictive covenant, it follows that the essential purpose of the parties, the essence of the deal, was the attempted acquisition by petitioner of rights under an employment contract which Klein could not unilaterally terminate.

B. RESPONDENT HAD SO MISCONDUCTED HIMSELF AS TO CREATE INFIRMITIES IN THE EMPLOYMENT CONTRACT WITH KLEIN

We have shown that petitioner had bargained for rights under a contract which Klein could not unilaterally terminate. We shall now demonstrate that petitioner did not obtain what it bargained for.

On two occasions, respondent converted corporate funds, once in the sum of $50,000, and once in the sum of $13,000. On August 11, 1944, respondent drew a check on the Klein account in the sum of $50,000 to his own order (R. 84, 137-138). The check stub read "Herbert Daniel Stone—Even Exchange—$50,000" (R. 139, 176). This stub was posted to a private ledger under an account labeled "Even Exchange" without any further identification or explanation (R. 140). The money was used by respondent to repay part of a personal loan from Marine Midland Trust Co. (R. 99-100). Respondent had borrowed $150,000 from the bank to purchase, along with a group of other persons, previously issued securities of Klein from the prior owners

of those securities (R. 98-99). Of the $150,000, respondent used $100,000 to purchase securities for himself, and $50,000 for other members of the purchasing group (R. 99). Respondent's use of corporate funds never appeared on any Klein financial statement (R. 130). Respondent claimed at different points in his testimony that he had notified the members of the executive committee of the board of directors (R. 85), and all of the directors informally (R. 92) of his conversion, each time specifically naming the chairman of the board of directors as one of the persons with whom he discussed the matter and from whom he had obtained approval. However, Mr. Handmacher (chairman of the board) testified (R. 128-129) that he not only did not consent to the conversion but knew nothing of it until he had been served with a subpoena to testify at the trial in this action. The $50,000 was returned on August 30, 1944 (R. 140).

On September 5, 1944, respondent drew a check on the Klein account in the sum of $13,000 to his own order (R. 87-88). This was recorded in exactly the same fashion as the previous withdrawal of $50,000 (R. 140, 175, 176). Again the directors of Klein were not notified (R. 129-130), although respondent made the same contentions to the contrary, and the transactions did not appear on any Klein financial statement (R. 130). The money was used by respondent to purchase some real estate for himself (R. 89), and was returned to the corporation on September 28, 1944 (R. 89). Respondent argued that he had believed the $13,000 was due to him as his share of the net profits of Klein pursuant to the employment contract. However, the net profits were "to be determined at the end of each fiscal year" (R. 11, 22) pursuant to the employment contract, and the fiscal year did not terminate until September 30, 1944 (R. 141). Hence, respondent was not entitled to draw any

corporate funds on that score until after September 30, 1944; and, then, he was only entitled to $4,309.66 (R. 142).

These conversions were unknown to petitioner until after respondent assigned his "rights" under the employment contract. None of the entries on the check stubs or in the accounts revealed that respondent had withdrawn the funds for personal use, as was acknowledged by the person who was auditor for Klein at the time the transactions occurred, (R. 138). No misconduct is involved in an even exchange which involves an immediate exchange of a check for cash or its equivalent but the term certainly does not cover a net withdrawal of funds constituting a defalcation by a corporate executive.

Moreover, no investigation was ever conducted by petitioner with respect to the letter agreement. Provision was made for an investigation in the securities agreement (par. 6, R. 49, 189, infra, p. 42) because the securities agreement contained various escape clauses permitting petitioner to terminate the agreement (par. 7, R. 49, 189, infra, p. 42). Pursuant to the securities agreement, petitioner's attorneys had possession of the Klein minute books for approximately three days prior to sending the notice that petitioner was ready to close (R. 117-118, 119, 162). There is nothing in the record to show that any books were examined with respect to the letter agreement. Of course, even if the financial records, as distinguished from the minute books, had been examined, and the entries discussed above observed, still, petitioner could not have known therefrom of respondent's conversions.

The defalcations were also unknown to the Klein directors. Thus when the Court of Appeals emphasizes the fact that the Klein corporation had never questioned the employment contract, it was really making a statement of little

significance, for the directors could not question what they did not know.

Under New York law "The rule is well settled that the officers and directors of a corporation occupy positions of trust in relation to their company and to its stockholders, and in all their dealings are bound to act with fidelity and in the utmost good faith . . ." *Winter* v. *Anderson*, 242 App. Div. 430, 431. Under Sec. 59 of the N. Y. Stock Corporation Law (infra, p. 43), no corporate funds may be lent to a stockholder except by a moneyed corporation. Since Klein was not a moneyed corporation [N. Y. General Corporation Law, Sec. 3 (6), infra, p. 43], any loan to respondent who was a stockholder was unlawful. *Murray* v. *Smith*, 166 App. Div. 528, modified on another point 224 N. Y. 40. Moreover, the withdrawal by a corporate officer of corporate funds for personal use constitutes a conversion of the funds, *Quintal* v. *Kellner*, 264 N. Y. 32, 35, even if the directors approve such withdrawal. *Marcus* v. *Otis*, 2d Cir., 168 F. (2d) 649.

Respondent had also fraudulently procured the write-off from the Klein books of personal charges against him for merchandise in the sum of $4,394.49 at cost and $5,359.13 at ticket price (R. 73-74). Respondent falsely represented to petitioner and to the directors and stockholders of Klein that he had distributed the merchandise for the good and welfare of Klein, and thereby procured the consent of petitioner and of Klein to writing off these charges (R. 67, 74-75, 108, 128, 157, 169-171). Respondent claimed that he had revealed the personal nature of the charges to Diamond who requested respondent to have false resolutions entered in the directors' and stockholders' minutes, and that although false minutes had been entered both the directors and stockholders had actually been correctly informed. Diamond, however, denied that respondent had notified him

of the personal nature of the charges and that he (Diamond) had requested respondent to have false minutes drawn (R. 108). Handmacher, chairman of the Board of Klein, testified that both the directors' and stockholders' minutes correctly stated what had occurred at the meetings and that respondent had represented to the directors and stockholders that the merchandise had been distributed for the good and welfare of Klein (R. 127). There was also testimony, again denied by respondent, that the latter had converted some personal property belonging to Klein while he was president of the corporation (R. 94-95).

These acts of misconduct which the Court below labeled as "technical irregularities" for which it was "inconceivable that the Klein corporation would have tried to rescind the contract" (R. 197), would clearly justify termination of the employment contract under New York law. What is inconceivable is that the Court could so characterize respondent's acts if it accepted the testimony supporting petitioner's case, as it must. The conversion of large sums of corporate funds, and dealing falsely with directors and stockholders are scarcely within the category of irregularities. Converting an employer's property, dishonesty, and bad faith are accepted grounds upon which a contract may be terminated in New York, *Hutchinson* v. *Washburn*, 80 App. Div. 367; *Gray* v. *Shepard*, 147 N. Y. 177; *Katz* v. *Goodman*, 176 N. Y. Supp. 488, and even for which past salary earned need not be paid. *Lamdin* v. *Broadway Surface Advertising Corp.*, 272 N. Y. 133, 137; *Sundland* v. *Korfund Co., Inc.*, 260 App. Div. 80.

There was thus ample evidence in support of petitioner's claim that it bargained for rights under an employment contract which Klein could not unilaterally terminate, and that it obtained an express oral warranty that the contract respondent had with Klein fell within that category.

The infirmities in that contract created not only a partial failure of consideration and partial breach of contract defeating the essential purpose of the bargain, but clearly revealed a mistake as to a material fact on petitioner's part, and fraud on respondent's part on which petitioner relied. Since the latter includes innocent misrepresentation of a material fact which is relied upon, a case has also been made out for relief on that ground.

II

A Verdict Should Have Been Directed in Favor of Petitioner Because Respondent's Implied Warranty Was Breached

The fact that a contract is in writing does not negate the existence of an implied warranty. *Hoisting Engine Sales Co.* v. *Hart*, 237 N. Y. 30, 35. Nor does the fact that an express warranty was made, not inconsistent with the implied warranty, preclude the existence of the latter. *Rinaldi* v. *Mohican Co.*, 225 N. Y. 70, 73. Nor does the language of the sale and assignment employed in the letter agreement negate the existence of an implied warranty that the employment contract was valid and subsisting and free from grounds upon which it could be terminated. The Court of Appeals did not suggest otherwise.

Respondent agreed to assign to petitioner all his "right, title, equity and interest in and to" the employment contract. In the case of the sale of realty, this language would imply simply that respondent was quit-claiming whatever rights he had. However, that is not so, for obvious reasons, in the case of a sale or assignment of the rights under a bilateral contract. A party to such a contract cannot transfer "his contract" since he has not only rights but also duties under the contract. The contract was as much the contract of Klein as of respondent. For this reason the ordinary language of the form books used to assign rights

under a bilateral contract is that which appears in the letter agreement. (See e. g., 7 Williston on Contracts, Form 165 at p. 5899, Form 166, Form 176).

An implied warranty is an obligation imposed by law in the interests of justice "to enable the purchaser to get what he paid for" *McClure* v. *Central Trust Co.*, 165 N. Y. 108, 122. The New York courts have held that there is an implied warranty that any instrument sold "is what it purports to be" (*Ledwich* v. *McKim*, 53 N. Y. 307); that on the sale of a chose in action it is impliedly warranted that no defense exists (*Delaware Bank* v. *Jarvis*, 20 N. Y. 226, 229, 231); that on the sale of a judgment which was obtained by an execution levy it is impliedly warranted that title to the judgment is not defective by virtue of an improper levy (*Flandrow* v. *Hammond*, 148 N. Y. 129); that on the sale of a tax lien there is an implied warranty that the lien is genuine, valid and subsisting (*County Securities, Inc.* v. *Warwick Properties, Inc.*, 176 Misc. 272, 275-276, aff'd 263 App. Div. 964, modified on other grounds and aff'd 289 N. Y. 774). In *Enterprise Brewery* v. *J. C. G. Hupfel Brewing Co.*, 176 N. Y. Supp. 105, the court held that on the sale of a liquor license, there was an implied warranty that the license was not subject to termination because of prior violations of the liquor laws by the seller. In *Nelson* v. *Hatch*, 70 App. Div. 206, aff'd, 174 N. Y. 546, the court held that upon the assignment of a part interest in a contingent fee contract, the assignor impliedly warranted that he would carry out the contract in accordance with its terms even though the other party thereto consented to its modification. Cf. *Meyer* v. *Texas Lumber Co.*, 150 So. 407, app. den. by Sup. Ct. (See *Collins* v. *Jones*, 152 So. 802, 804).

Under New York law an implied warranty may be negated only by an express provision of the contract. However, it

may also be defeated by the presence of an element negating reliance, such as knowledge of the defect. *Carleton* v. *Lombard, Ayres & Co.*, 149 N. Y. 137, 146; *Becket* v. *Smithers*, 50 N. Y. Super. Ct. (18 Jones & Spencer) 378, 385.

The Court below, relying upon the Restatement,[8] held that an implied warranty may be negated by circumstances showing a contrary intention. In this respect, the Restatement goes beyond any New York case, but assuming, *arguendo*, that it does state the New York law, the Court below still erred in making its inference. The mere fact that rights are purchased under a contract in order to enable the other party to the contract to terminate it does not lead to the inference that the purchaser would have been willing to purchase the rights if the other party could have terminated the contract unilaterally. The party to be relieved may engage in self-help under those circumstances.

On respondent's own admissions referred to above (pp. 25-27), respondent converted $63,000 of corporate funds. Even if we accept his claim that the directors were notified, the character of the conversion is unaltered. *Marcus* v. *Otis*, *supra*; Cf. *Equity Corp.* v. *Groves*, 294 N. Y. 8, 11-13; *Flanagan* v. *Flanagan*, 77 N. Y. S. (2d) 682; *Zahn* v. *Transamerica Corporation*, 3d Cir., 162 F. (2) 36. The conversion of funds alone would be sufficient to warrant the termination of the employment contract.

By reason of the implied warranty and the respondent's undisputed conversion of funds, a sufficient case was made out of breach of contract and failure of consideration to justify either termination or rescission. Therefore, sufficient undisputed facts appear in the record to warrant a directed verdict for petitioner.

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[8] Only one New York case (the only case cited) was cited by the Court below and that with reference to a point it found unnecessary to decide.

Conclusion

Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit to review its judgment.

Respectfully submitted,

DAVID MACKAY,
Attorney for Petitioner.

EMANUEL L. GORDON,
of Counsel.

APPENDIX A [9]

Plaintiff's Exhibit 3

1. We do jointly and severally warrant, represent and agree as follows:

(a) S. Klein On The Square, Inc. (hereinafter referred to as the "Corporation") is a corporation duly organized and existing under the laws of the State of New York, having the following authorized capitalization:

20-year 8% Debentures in the principal amount of $800,000, due April 1, 1964, interest on which is payable semi-annually on the first days of April and October, said Debentures being subordinate to claims of creditors, all of which are duly issued, outstanding and fully paid.

10,000 shares of 8% Cumulative Preferred Stock with a par value of $100 per share, 2,000 shares of which are duly issued, outstanding, fully paid and non-assessable.

14,000 shares of Common Stock without par value, consisting of:

4,000 shares of Class A Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

4,000 shares of Class B Common Stock all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class C Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class D Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class E Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

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[9] See R. 189.

1,500 shares of Class F Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable.

All of said shares of Common Stock have equal rights and participation, except that the holders of the shares of Class A and Class B Common Stock are each entitled to elect three Directors, and the holders of the shares of Class C, Class D, Class E and Class F Common Stock are each entitled to elect one Director.

None of the above Debentures are in default and there are no dividend arrears on any of the said shares of Preferred Stock.

(b) Each of the persons, firms and corporations listed in Schedule "A" hereto annexed owns the principal amounts of said Debentures, and the numbers of shares of said Preferred and Common Stock set beside their respective names, which constitute all of the presently outstanding securities of the Corporation, and at the time of closing each will have the right to make the sale and transfer herein contemplated.

(c) As at the date of closing, there will be no options, commitments or other rights or liens in existence with respect to or against any of the said Debentures or shares of Preferred and Common Stock, either issued or unissued.

(d) The Corporation has never done business and has never been qualified to do business in any state other than New York.

(e) Since its organization, the Corporation has been engaged in the retail sale of women's clothing and accessories.

(f) The Corporation's only subsidiaries are:

Fourteenth Street Trading Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which engages in the operation of a restaurant on the Corporation's premises;

S. Klein Fur Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which engages in the operation of the fur department at the Corporation's premises.

S. Klein Trading Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which has done no business but which has applied for a New York State retail liquor license.

(g) The Corporation's fiscal year ends on September 30th. All tax returns of every kind required to be filed by or on behalf of the Corporation and its subsidiaries for all periods ended on or prior to the date hereof have been duly and properly filed, and all taxes of every kind payable by the Corporation and its subsidiaries for all periods ended on or prior to the date hereof have been duly paid. At the time of closing, all such tax returns for all periods ended on or prior to the date of closing hereunder will be duly and properly filed, and all such taxes for all periods ended on or prior to the date of closing will be duly paid, or reserves therefor will have been established and duly reflected on the books of the Corporation and of its subsidiaries.

(h) Neither the Corporation nor any of its subsidiaries is a party now engaged in any suits, actions or other legal proceedings; neither the Corporation nor any of its subsidiaries has received, within two years prior to the date hereof, any claims or demands stating or threatening that legal proceedings will follow a refusal on the part of the Corporation or any of its subsidiaries to comply with any such claim or demand and which, since receipt thereof, has not been settled without present liability to the Corporation and its subsidiaries, except such suits, actions, legal proceedings, claims and demands which are fully covered by insurance maintained by the Company for its benefit or the

benefit of its subsidiaries; there are no pending proceedings and the undersigned know of no contemplated proceedings by governmental authorities against the Corporation, its subsidiaries, or the properties thereof.

(i) The Corporation and its subsidiaries have made no agreements, commitments or contracts which as at the date of closing hereunder will be still outstanding, other than agreements, commitments and contracts referred to in Schedule "B" hereto annexed. As at the time of closing, neither the Corporation nor any of its subsidiaries will be in default with respect to any such agreements, commitments or contracts. As at the date of closing, the Corporation and its subsidiaries will have duly performed each and every term and condition on their parts to be performed pursuant to such agreements, commitments or contracts.

(j) The Corporation at December 31, 1945 had a net worth of not less than $1,300,000 represented by approximately $265,000 of fixed assets and approximately $1,035,000 in current and other net assets and at the time of closing hereunder the Corporation's condition will be substantially as above stated.

(k) The Corporation occupies the premises at which it presently conducts its business pursuant to lease dated April 11, 1944, which expires on April 15, 1965, and which contains an option in favor of the tenant to renew said lease as to all of the demised premises for a period of twenty-one years, and to successive options in favor of the tenant to renew as to all or part of said premises demised pursuant to terms and conditions therein specified. Said lease provides for rental during the term thereof and for the first renewal period of Three Hundred Thousand Dollars ($300,000) per annum, plus two percent of the gross business done at said premises by the tenant in excess of Twelve Million Dollars ($12,000,000) per annum.

(l) Between the date hereof and the date of closing hereunder, no new securities of the Corporation or its subsidiaries will be authorized or issued, no dividends will be declared or paid, and no liability will be incurred by said corporations or entered upon said corporation's books ex-

cept in the ordinary and regular course of business, and at the time of closing hereunder, the corporation will be conducting a going business of the nature, condition and with assets substantially similar to that conducted by it on the date hereof.

(m) Following the closing hereunder, none of the present officers, directors, Debenture holders or stockholders of the Corporation will employ or become associated in business with any of the present executive employees of the Corporation or its subsidiaries, unless said employees shall theretofore have ceased their employment with such corporations without interference or inducement, direct or indirect, by said officers, directors, Debenture holders or stockholders.

(n) Following the closing hereunder and for a period of twenty-one (21) years thereafter, none of the present officers, directors, Debenture holders or stockholders, under the name "Klein", or any imitation or simulation thereof, will anywhere engage in or in any manner whatsoever be or become interested in, directly or indirectly, as owner, partner, agent, stockholder, director, officer, employee or otherwise, in a business, trade or occupation similar to or competitive with the business presently conducted by the Corporation.

* * * * * * *

6. You are hereby granted permission to examine any and all records, documents and property of the corporation and its subsidiaries, such examination to be conducted by your attorneys, accountants or other representatives at all reasonable times and hours following the execution of this agreement and prior to the closing hereunder.

7. In the event that the investigation to be conducted by you shall disclose any substantial variance from the representations contained herein, you shall have the right to refuse to consummate the purchase herein contemplated, and in the event of such refusal the aforesaid sum of Two Hundred Fifty Thousand Dollars ($250,000) being delivered by you simultaneously with the execution and delivery of this agreement shall be forthwith returned to you by said

escrow agents and there shall be no further liability on the part of any party to the others. You may also designate a reasonable number of representatives who, between the date hereof and the time of closing hereunder or until you shall refuse to consummate the purchase herein contemplated, shall be permitted to be present at the Corporation's premises for the purpose of observing the Corporation's operations, facilitating the completion of your investigation, and otherwise preparing for the taking over of the business by you.

APPENDIX B

Statutes

New York Civil Practice Act, Section 112-g

> "Tender of benefits by party rescinding transaction. A party who has received benefits by reason of a transaction voidable because of fraud, misrepresentation, mistake, duress, infancy or incompetency, and who, in an action or proceeding or by way of defense or counterclaim, seeks rescission, restitution or other relief, whether formerly denominated legal or equitable, dependent upon a determination that such transaction was voidable, shall not be denied relief because of a failure to tender before judgment restoration of such benefits; but the court may make a tender of restoration a condition of its judgment."

New York General Corporation Law, Section 3(6)

> "A 'moneyed corporation' is a corporation formed under or subject to the banking law or the insurance law."

New York Stock Corporation Law, Section 59

> "No loan of moneys shall be made by any stock corporation, except a moneyed corporation, or by any officer thereof out of its funds to any stockholder therein, nor shall any such corporation or officer discount

any note or other evidence of debt, or receive the same in payment of any instalment or any part thereof due or to become due on any stock in such corporation, or receive or discount any note, or other evidence of debt, to enable any stockholder to withdraw any part of the money paid in by him on his stock. In case of the violation of any provision of this section, the officers or directors making such loan, or assenting thereto, or receiving or discounting such notes or other evidences of debt, shall jointly and severally, be personally liable to the extent of such loan and interest, for all the debts of the corporation contracted before repayment of the sum loaned, and to the full amount of the notes or other evidences of debt so received or discounted, with interest from the time such liability accrued."

APPENDIX C

Original Opinion

Stone v. *Grayson Shops, Inc.*

After stating facts as they appear at R. 193-196:

FRANK, *Circuit Judge:*

Defendant asserted as its chief defenses (1) fraud, (2) breach of an express warranty, and (3) breach of an implied warranty. We think the trial judge correctly decided that, in support of these defenses, there was not evidence sufficient to go to the jury. Diamond, an experienced lawyer, who appeared in this suit as defendant's counsel, merely gave his understanding of what plaintiff said to him, but did not narrate what plaintiff said. In the circumstances, such testimony was not enough to serve as a foundation for a defense of fraud or misrepresentation, or express warranty.[10]

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[10] We need not, therefore, decide whether oral testimony could be considered in support of an express warranty in the face of the written con-

Even, however, if such a vague express warranty was given, it appears to mean only that Stone was giving up a valuable contract which would not be rescinded by Klein. So understood, the statement, if we regard it as sufficiently proved, was true, for, in assigning his contract and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned. His contract was a good one, in the practical sense that Stone's relationship with the Klein company was such that he could expect employment at the contractual rate for the duration of the contract term. It is inconceivable that the Klein corporation would have tried to rescind the contract on account of the technical irregularities alleged.

To go a step further, we might assume as a fact that the Klein company has a remedy to recover from plaintiff any part of the funds or property allegedly converted. There is no evidence, however, as to how knowledge of this fact would have caused defendant to change the terms of its bargain with plaintiff; and, looking at the whole transaction, we think it would not make a sufficient difference to justify rescission of the contract between plaintiff and defendant. In addition to the desired benefit to defendant of getting rid of plaintiff's employment contract without a dispute or lawsuit, defendant obtained from plaintiff an agreement to refrain from assuming an executive position with any ladies' apparel department store in the borough of Manhattan for a period of six years, and also obtained the consent of plaintiff—an important figure in the negotiations—to the sale of the Klein stock.

Nor, on the facts, was there an implied warranty of the validity of the employment contract. While, ordinarily, an assignor of a contract right makes an implied warranty "that the right, as assigned, actually exists and is subject

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tract and written assignment. Cf. *Zacharia* v. *Osaka Textiles, Inc.*, 7 N. Y. S. (2d) 696.

Nor, as bearing on fraud or misrepresentation, need we take account of the fact that defendant had examined the corporate records and might therefore have known of the alleged infirmities in plaintiff's employment contract.

to no limitations or defenses other than those stated or apparent at the time of the assignment''—Restatement of Contracts, § 175—this rule applies only where the facts do not show a contrary intention. Assuming, *arguendo*, that the contract right here was subject to a defense which was not apparent, we think the facts disclose such a contrary intention, since defendant did not intend to exploit the contract. Looking at the whole situation, we agree with the trial judge that defendant obtained just what it bargained for. In purchasing the business, defendant wanted to replace the old officers and directors with its own staff of executives. To do so, it had to be rid of plaintiff, and therefore had to buy up or procure a release of his five-year contract. Obviously, defendant never itself intended to enforce that contract against the Klein corporation. Indeed, it could not have done so, for nothing would be due thereunder unless plaintiff continued to work for the Klein corporation. Patently defendant desired only to be free of plaintiff without a dispute or lawsuit. This the defendant got.

Defendant also argues that the assignment is invalid because there was not a quorum of disinterested directors present when the Klein corporation consented to the assignment. Perhaps such a consent would have been necessary if Grayson, as assignee, had intended to enforce the contract with the Klein company by naming plaintiff's successor. But here the purpose of the assignment was to terminate the contract with the Klein company, thus extinguishing plaintiff's rights thereunder; accordingly, so far as the defendant was concerned, there was no need to obtain the consent of the old management of the Klein corporation to the contract between the plaintiff and the defendant.

Affirmed.

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Table of Cases Cited

Other Authorities Cited

Supreme Court of the United States

OCTOBER TERM 1948

No. 765

THE GRAYSON SHOPS INCORPORATED (OF CALIFORNIA), NAME CHANGED TO GRAYSON-ROBINSON STORES, INC.,

Petitioner,

v.

HERBERT D. STONE.

PETITIONER'S REPLY BRIEF

Statement

Respondent, in his effort to confuse the issues, chooses to discuss matters not raised in the petition. In addition, respondent refers to some alleged arguments and cases in petitioner's brief which do not appear at all therein. This reply will be limited to those matters as to which respondent has attempted to make answer to the issues raised in the Petition.

Argument

1. We have urged that the direction of a verdict against the petitioner was error, and, in our main brief, have shown that there were numerous issues of fact which should have been left to the jury, and which the Court of Appeals itself assumed to determine. Respondent (Br. pp. 8-12) seeks to sustain the direction of a verdict on the theory

that the court below was required to weigh the evidence and to direct a verdict in respondent's favor if, on a motion for a new trial, a jury verdict for petitioner would have been set aside as against the weight of the evidence. We have pointed out at page 9 of the Petition that the Court of Appeals for the Second Circuit has, in several cases in addition to the instant one, directed verdicts or sustained directed verdicts, on issues other than negligence, predicated upon its judgment as to the weight of the evidence and credibility of the witnesses. This the respondent, far from denying, undertakes to justify as the proper standard.

In line with his view of the appropriate standard, respondent discusses and urges this Court to pass upon the credibility of the witnesses. Thus, at pp. 34 and 49-50 of his brief, respondent attacks Diamond's credibility in testifying that the negative covenant was inserted in the letter agreement solely at respondent's request and to accommodate him; at pp. 13-14 and 30-31 he attacks the credibility of Handmacher, chairman of the Klein board, who denied respondent's testimony that he (Handmacher) had been notified of respondent's use of corporate funds for personal purposes, and denied that respondent had informed the directors and stockholders of Klein that respondent's charges on the Klein books were personal ones prior to procuring their write-off (see Br. p. 22 where respondent fails to mention this denial); and at pp. 27-28, where he attacks Lauterbach's credibility.

In support of his position that the court must weigh the evidence on a motion for a directed verdict, respondent cites cases in this Court, and in the Third and Eighth Circuits (Br. pp. 8-12), which are indicated to be contrary to the cases cited in petitioner's brief at pp. 13-14 with respect to the proper standard to be applied upon a motion for a directed verdict, and at p. 20 with respect to testing the credibility of witnesses. The attention of the Court is respectfully called to its more recent decisions in *Montgomery Ward & Co.* v. *Duncan*, 311 U. S. 243, 249, 251 and *United*

States v. *Socony-Vacuum Oil Co.*, 310 U. S. 150, 254 where it held that a Federal court may not upon a motion for a directed verdict weigh the evidence as it would upon a motion for a new trial. The holding in these cases are in direct conflict with the language of *Pennsylvania Railroad Co.* v. *Chamberlain*, 288 U. S. 333, 343 cited by respondent. We note that the following decisions in the circuits indicated are in accord with the *Montgomery Ward* case, *supra*: *Hawkins* v. *Sims*, 4th Cir. 137 F. (2d) 66, 67; *Pruitt* v. *Hardware Dealers Mut. Fire Ins. Co.*, 5th Cir. 112 F. (2d) 140, 143; *General American Life Ins. Co.* v. *Central Nat. Bank*, 6th Cir., 136 F. (2d) 821, 823; *Adams* v. *United States*, 7th Cir. 116 F. (2d) 199, 202; *Childs* v. *Radzevich*, D. C. Cir., 139 F. (2d) 374. This confusion and the continuing conflict among the circuits with respect to so important a question as the proper standard to be applied upon a motion for a directed verdict gives added emphasis to the reasons for granting the writ as set forth in the Petition.

While the greater part of respondent's brief is devoted to an analysis of the evidence in terms of its weight, framed as though this were a motion for a new trial, we do not feel required to answer in those terms which we think irrelevant.

2. Respondent's entire attempt to answer petitioner's claim that the assignment of his employment contract carried with it an implied warranty that the contract was not subject to unilateral termination by Klein is to be found in the seventeen lines at pp. 48-49 of his brief. Respondent there seems to assume that we rely on a warranty of *fitness for purpose*. But petitioner is not relying on a fitness warranty, quite apart from any doubts there may be as to whether such a warranty has any application to the assignment of a chose in action.

Petitioner has shown at page 35 of its brief that under the New York law there is an implied warranty when rights under a contract are assigned that such rights are not sub-

ject to termination as a result of the prior misconduct of the assignor. Respondent cites no authority to the contrary. The court below conceded that an assignor ordinarily makes such an implied warranty (R. 196).

Petitioner's argument is that the court below erred in holding that under New York law an implied warranty may be negatived by any facts short of an express provision in the contract or acts which would preclude reliance. Moreover, even if the court below was correct in stating that a warranty may be implied only where *the facts* do not show a contrary intention, it erred in sustaining the directed verdict because it was for the jury to determine the fact of intention—the jury was free to find that petitioner would not have paid $200,000 to enable its prospective subsidiary to terminate respondent's contract if it had known that the subsidiary was itself free to terminate them.

3. At pp. 14-15, 35, 36, 43 and 45 respondent asserts that the securities agreement and letter agreement were consideration for one another because respondent would not have sold his securities unless petitioner purchased his rights under the employment contract. The only citations to the record which respondent gives are ff. 330-331 and 336. But nowhere in those folios—or anywhere else in the record—does any such testimony appear. At the cited folios, Diamond testified that respondent's securities could not be purchased by petitioner unless respondent agreed to sell them, and that all the stockholders had a prior right to purchase each other's securities upon a sale. But Diamond did not testify that respondent would not have sold his securities had petitioner declined to purchase the contract rights. In fact, his testimony is to the contrary (R. 105). It should be noted that respondent took the stand several times during the course of the trial but at no time did he testify that he would not have sold his securities had petitioner refused to purchase the employment contract rights.

It is true, as respondent states, that the letter agreement was, by its terms, conditioned upon a closing under the securities agreement (R. 152). That was done because petitioner sought to relieve a prospective subsidiary of what had been represented to petitioner to be (and of what it believed to be) rights not subject to unilateral termination by the prospective subsidiary. Of course, if Klein were not to become a subsidiary of petitioner, it would have no interest in the employment contract. It will be noted, however, that the *securities agreement* was in no way conditioned on the *letter agreement*.

The only *fact* upon which respondent and the court below contend that the securities agreement and letter agreement were consideration for one another is that they were executed on the same day. Petitioner cited *Petze* v. *Leary*, 117 App. Div. 829 and *Topken, Loring & Schwartz, Inc.* v. *Schwartz*, 249 N. Y. 206, 208, 211 in support of its contention that under New York law such an inference may not be made. Respondent notes at page 50 of his brief that the *Petze* case states that the execution of one contract *may* constitute consideration for the execution of a second contract. But this dictum appears in no way inconsistent with the holding that the simultaneous execution of two contracts is insufficient to prove that the execution of one contract was consideration for the execution of the second even though one merely provides for additional consideration for carrying out the second.

In the *Topken* case, defendant entered into an employment contract with plaintiff corporation. In a separate contract, executed the same day, defendant purchased some stock in plaintiff corporation and it was agreed that, upon termination of defendant's employment, defendant would sell and plaintiff would repurchase the stock (249 N. Y. at 208). It was held that the corporation's promise to repurchase the stock did not constitute a valid consideration because it was illusory in view of the limitations upon a corporation's power to purchase its own stock.

The New York Court of Appeals stated, however, that there would have been valid consideration for the securities contract had it been shown that the execution of the employment contract was consideration for the securities contract (249 N. Y. at 211). Since the Court found no consideration had been furnished by the corporation, it held that the execution of both contracts on the same day could not support the implication that one was consideration for the other.

4. Respondent contends (Br. pp. 18-19) that petitioner must show that Klein terminated his employment contract as a result of respondent's misconduct before petitioner may complain of any infirmity in the rights respondent transferred. Petitioner acquired respondent's rights in order to terminate them because it was represented to it, and it believed, that Klein could not unilaterally terminate the contract. Upon the assignment of those rights, respondent left the post of general manager of the store and the employment contract was thus automatically terminated. As to that there is no dispute. When petitioner and Klein learned of respondent's prior misconduct, there was nothing further which could be done because the contract no longer existed.

Respondent goes on to argue that the misconduct alleged was solely against Klein, and that petitioner may therefore not complain. But when petitioner agreed to pay $200,000 for respondent's rights, it bargained for rights which Klein did not have the *power* unilaterally to terminate. If it failed to receive such rights there was a failure of consideration and breach of both the express and implied warranty irrespective of what Klein did or would have done.

In *Nelson* v. *Hatch*, 70 App. Div. 206, aff'd. w.o. op. 174 N. Y. 546, the defendant, an attorney, agreed to represent a client on a contingent fee basis. It was agreed that defendant's partner would render services whenever neces-

sary or when requested by the client. Plaintiff agreed with defendant to finance the litigation in return for an assignment of one-half of the partnership's interest in the recovery. Defendant's partner terminated the partnership and withdrew from the litigation. The client agreed that defendant alone should try the case. The plaintiff, not having been consulted, sued to recover the amounts he had advanced. The Court held that there was an implied warranty upon the assignment to plaintiff that defendant's contract with his client would be carried out in accordance with its terms (pp. 211-212), and that the plaintiff, under his warranty, could complain of defendant's departure from the terms of his contract with the client, despite the client's consent thereto.

Respondent's argument that petitioner cannot complain unless Klein actually terminated his employment contract because of his prior misconduct is bottomed on the assumption that petitioner was concerned with what Klein *would* do. Petitioner was acquiring control of Klein; it would decide what Klein would do. Its only concern was with Klein's *power* to act, or at least the jury could have so found.

5. At pp. 39 and 44 of his brief, respondent contends that even if the employment contract were subject to infirmities because Klein could have discharged him, he nevertheless furnished consideration to petitioner by leaving his post without a lawsuit. Under New York law, benefits and detriments do not constitute consideration unless they are bargained for. There is not the slightest evidence in the record that petitioner bargained for freedom from a lawsuit, and hence respondent's leaving his post furnished petitioner with no bargained for consideration if Klein could have discharged him.

In *Tams-Witmark Music Libary* v. *New Opera Co.*, 298 N. Y. 163 (July 16, 1948), defendant agreed to pay royalties for the exercise of certain performing rights which the

plaintiff warranted were within its exclusive possession. Whether or not they were was a doubtful question. It was subsequently decided that those rights were in the public domain. Upon learning of the decision, defendant refused to pay the agreed royalties, alleging failure of consideration and breach of warranty. The New York Court of Appeals sustained its position even though defendant, by virtue of its agreement with plaintiff, had been able to exercise the performing rights free of a lawsuit. The vice of plaintiff's case was that it sought to obtain a payment for the exercise of a right which defendant was free to exercise without payment. Respondent's case is subject to the same deficiency.

6. At pp. 36-37 of respondent's brief the position is taken that the promise contained in the letter agreement to resign as an officer and director of Klein and of its subsidiaries had some special value, greater than the same promise contained in the securities agreement, and that the two promises were simultaneous.

In the securities agreement to which respondent was a party, he promised to deliver at the closing the "Resignations of all Directors, officers, attorneys-in-fact and agents of the [Klein] Corporation and its subsidiaries" (R. 151). The letter agreement provided that in the event of a closing pursuant to the securities agreement, respondent promised "to resign as an officer and director of said company [Klein] and of its subsidiaries" (R. 152). Thus, the promise in the letter agreement added nothing whatever to that contained in the securities agreement and the former would go in effect only after the resignations had already been given. Such a promise cannot constitute consideration under *Petze* v. *Leary*, 117 App. Div. 829. In that case, plaintiff entered into an employment contract with a corporation, and simultaneously entered into another contract with an officer-stockholder of the corporation under which plaintiff would obtain additional compensation for carrying

out the first contract. The court held that no consideration existed for the second contract.

7. Respondent at pp. 37-39 of his brief distorts petitioner's argument with respect to the negative covenant contained in the letter agreement. He attempts to show that this negative covenant was broader than the one contained in the securities agreement. Petitioner does not argue otherwise. But we do contend (see Br., p. 27) that petitioner obtained all the protection it desired by the negative covenant contained in the securities agreement. Petitioner's testimony was that the negative covenant was inserted solely at respondent's request and to accommodate him (R. 107-108). It was not a significant element of the bargain, and would certainly not have led petitioner to enter into the letter agreement had the infirmities in the employment contract been known.

To buttress his argument as to the value of this negative covenant, respondent's brief states (Br., pp. 38-39) that he had successfully managed Klein for nearly two years. The statement is gratuitous, and nowhere supported in the record, but, since respondent nevertheless feels free to make it, we feel justified in noting that the fact is just to the contrary. During the period of respondent's management, the highly profitable war years, Klein's was, considering the size of its operations, barely in the black. The only record evidence with respect to profits is that respondent's share of 5% thereof before income taxes for 5½ months was $4,309.96. Respondent concedes the correctness of this figure (Br., p. 49). On an annual basis, this would yield less than $190,000 profit before taxes—a nominal profit for one of New York City's largest department stores.

Respondent further asserts, without the slightest foundation in the record or in fact, that in a prospectus and registration statement, petitioner "purported to set forth all the advantages resulting to petitioner from the transaction and to put it in the most favorable light". Respond-

ent further asserts again that petitioner listed the negative covenant as an "advantage" but failed to mention any warranty with respect to the letter agreement. The portion of the prospectus and registration statement relied upon purports only to state some of the terms, without suggesting whether they were advantages or disadvantages; the original documents had but a six line summary and they expressly warned (p. 14) that "the foregoing statements are brief summaries" and "Such statements do not purport to be complete".

As Diamond testified (R. 124), there is no Federal requirement that every term and condition be reported unless it is necessary to prevent a statement from being misleading. Section 11(a) of the Securities Act of 1933 requires the revelation of any material fact "necessary to make the statements therein not misleading" and Section 17(a) requires the revelation of any material fact "necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading . . ." There was no requirement that the express warranty be revealed, but if the appellant had had any knowledge of any infirmities in the letter agreement, or if it had paid respondent to be free of a possible lawsuit, it would have been necessary to reveal those facts.

8. Diamond testified in part that the substance and meaning of what respondent had represented and warranted to him was that the employment contract was "free from infirmities" (R. 105-106, 109, 115). Respondent asserts (Br. pp. 33-34), without citing any authority, that Diamond's testimony "did not establish the making of the alleged representation" because only the meaning of respondent's words and not the exact words had been given. The New York and Federal authorities cited by petitioner in its brief at pp. 19-20 establish that testimony giving the meaning of the words used is sufficient to prove a representation and warranty.

9. In its main brief, petitioner argued that the $200,000 which it agreed to give respondent was of such size that a jury could have found that it represented the full value of respondent's contract, and hence was not arrived at as a compromise figure paid to avoid a lawsuit. Respondent objects (Br. p. 49) to this statement. At the date of the closing, the employment contract had 3 years, 1½ months to run. During that period respondent would have received $30,000 per annum as salary, and 5% of the net profits. Respondent concedes that respondent's share of the profits before taxes for 5½ months was $4,309.96. On that basis, respondent would have received, in salary and in profit-sharing, less than $125,000 over the remaining period of his contract (computed on an annual average profit before taxes of $188,000).

Respondent argues that the 5½ months profit figure was not representative because improvements were made in the store during that period. First, we note that under accepted accounting practice improvements are written off over their life so that the year in which they are made does not yield unusual results on that account. Second, there is no testimony that such improvements were made. If we are to go outside the record, we may as well look at the actual operating results under respondent's management. During the full fiscal year following the 5½ month period (October 1, 1944 to September 30, 1945), Klein's own statement of profit and loss showed a profit of only $149,799.10 before taxes, and of $73,095.81 after taxes. Hence, despite respondent's complaints, petitioner's assumption, supported by the record, of a profit before taxes of $188,000 per annum is somewhat generous to respondent.

10. Respondent argues at numerous points that petitioner made its own investigation in entering into the letter agreement with respondent and therefore cannot rely upon respondent's representations (Br. pp. 5-6, 33, 34-35). As petitioner pointed out in its brief at page 31,

the letter agreement contained no provision for an investigation. Such provision was contained only in the securities agreement and only with respect to the representations made in that agreement.

It should first be noted that respondent cannot contend that petitioner did not rely upon his representations in entering into the letter agreement since it had conducted an investigation under the securities agreement because *the investigation was made after the letter agreement was executed.* That is the short answer to respondent's argument of lack of reliance. In addition, we reiterate that the investigation was solely with respect to the securities agreement. When respondent states at page 33 of his brief that petitioner "expressed itself as satisfied, and prepared to close and did close the deal (f. 485)" he is talking solely of the securities agreement. The letter in the record to which reference is made is addressed to the signatories of the securities agreement, and it expressly refers only to the purchase of the securities. Finally, we note that in connection with the securities investigation, petitioner could not discover anything with respect to respondent's misconduct because they were not revealed by the records, as will be shown below.

At pp. 32-33 of its brief petitioner cites the evidence in the record from which the jury could have found that respondent fraudulently procured the write-off by Klein of his personal charges appearing on its books. Respondent argues that the charge on the books merely created an indebtedness; that, however, does not justify his fraud in procuring the write-off. Respondent argues that he might have offset that sum against the monies due him from Klein—"a practice which was apparently followed on other occasions (f. 307)." But respondent never offset such personal charges; he had them written-off without payment upon fraudulent representations. Moreover, the "practice" to which he refers was simply another conversion of corporate property by respondent himself. The

facts concerning the latter act are set forth in petitioner's brief at pp. 30-31.

In purporting to summarize the record in his brief at pp. 22-23, respondent attempts to make much of the failure of Kuchai (petitioner's president) to testify with respect to the write-off of the charges. Respondent fails to state that he, himself, had testified (R. 74) that he had negotiated for petitioner's consent to the write-off with Diamond. Diamond did testify, and stated that respondent did not reveal that the charges were actually personal ones rather than for corporate purposes, as stated in the resolutions passed by the Klein directors and stockholders. Diamond further denied that he (Diamond) had suggested the false resolutions (R. 108). Moreover, respondent fails to point out that Handl[illegible]cher, chairman of the Klein board, testified (R. 127) that the directors' and stockholders' resolutions correctly reported that respondent had represented to the meetings that the charges had been incurred for corporate purposes. On this conflict of testimony, respondent urges that his version be accepted by the Court. This is precisely what the court below did; it weighed the credibility of the witnesses.

Respondent attempts to justify his acts by the claim that Klein was a family corporation in which formalities may be disregarded—citing *Gerard* v. *Empire Square Realty Co.*, 195 App. Div. 244. An examination of that case will reveal that Klein was not a family corporation within the meaning of that term as it is used in the *Gerard* case, and that respondent's acts were not the mere omission of formalities. In the *Gerard* case the sole stockholders (who were also directors) were four brothers and a sister; Klein had at least 38 stockholders (see respondent's brief pp. 23-24), some of whom were in some way related to the late Samuel Klein, some of whom were employees of Klein, and some of whom were simply outside investors. Only a fraction of the stockholders were directors. In the *Gerard* case, all stockholder-directors had approved a con-

tract, but this had been done individually, without a meeting because of personal bickering. In the instant case, respondent is charged with procuring the write-off of personal charges on the corporate books, and he has admitted the conversion of corporate funds.

The holding that in a closely held, family corporation, unanimous approval sufficed without a meeting does not justify respondent's acts. The Court stated in the *Gerard* case, at p. 249:

> "I think that under the circumstances of the case we are considering, where the directors own all the capital stock of the corporations, where they are members of the same family but so at variance that directors' and stockholders' meetings are not held, their action, concurred in by all, although separately and not as a body, binds the corporation. We must recognize the fact that to a greater and greater degree all business, great and small, is being brought under the management of corporations instead of partnerships; that they are, in perhaps the majority of instances, conducted by officers and directors little informed in the law of corporations, who often act informally, sometimes without meetings or even by-laws. To hold that in all instances technical conformity to the requirements of the law of corporations is a condition to a valid action by the directors, would be to lay down a rule of law which could be used as a trap for the unwary who deal with corporations, and to permit corporations sometimes to escape liability to which an individual in the same circumstances would be subjected."

Respondent also contends that his conversion of $63,000 of corporate funds constituted a mere "technical irregularity" (Br. pp. 29-33). He attempts to throw a charitable purpose around his first conversion of $50,000 by asserting that it was for the benefit of the family, relatives and employees of S. Klein. He omits to point out that the money was used to repay a loan he had made in order to purchase $100,000 of securities for himself (R. 99).

Respondent's assertion that Klein knew about the conversion is predicated upon the "Even Exchange" entry in the books. But Jayson, who was the Klein auditor at the time of the transaction, admitted in his testimony that the entry did not reveal a personal use of corporate funds (R. 138). This is obviously so since an "even exchange" involves no net withdrawal; it is a simultaneous exchange. Moreover, the entries did not appear on the monthly statements given to the directors (R. 130), and Handmacher, chairman of the Board (and the only person specifically named by respondent during his testimony as having been informed by him of the withdrawal) denied having any knowledge thereof (R. 128-129). Respondent's only answer is to attack Handmacher's credibility (Br. pp. 30-31)—an issue clearly for the jury. Respondent at numerous points attempts to imply that evidence appears in the record by stating questions propounded to a witness although a negative answer was received, and no testimony to the contrary appears. For example, at page 30 respondent states in his brief that Handmacher denied knowing that Berkeley and Rosenblum, members of the Klein executive committee, had each loaned respondent $25,000 to repay $50,000 to Klein. The statement implies that there is other testimony in the record that these two directors had loaned respondent the stated sums to repay the corporation. Actually, there is no such testimony that they had loaned him anything.

Respondent attempts to justify his conversion of $13,000 (Br. p. 32) on the ground that he mistakenly believed that his share of the profits to become due from Klein was a greater sum. The explanation is specious, for (as petitioner pointed out at pp. 30-31 of its brief), respondent was not entitled under his contract to any payment until the close of the fiscal year, and the conversion occurred before that date.

It should be emphasized that respondent makes no attempt to distinguish or controvert the applicability of the

statutes and cases set forth at pages 32 and 36 of petitioner's brief, which hold it to be unlawful for a corporation such as Klein to lend its funds to a stockholder, the respondent, and which hold that the use by an officer of corporate funds for his personal benefit constitutes a conversion even if the directors of the corporation consent. In the face of this law, respondent still asserts that his conversion constituted only a "technical irregularity," not justifying his discharge, although no authority is cited in support of that view.

Respectfully submitted,

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Of Counsel.

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Supreme Court of the United States

OCTOBER TERM, 1948

No. 765

THE GRAYSON SHOPS INCORPORATED (of California) name changed to GRAYSON-ROBINSON STORES, INC.,

Petitioner,

v.

HERBERT D. STONE,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

THOMAS A. GAFFNEY,
Counsel for Respondent.

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Statement.

Respondent submits this brief in opposition to the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

Petitioner appealed to the Court of Appeals from a judgment in favor of the respondent in the sum of $150,000, with interest and costs, entered upon a directed verdict in the office of the Clerk of the United States District Court for the Southern District of New York, on November 4, 1948, after a trial before Hon. Simon H. Rifkind, D. J., and a jury.

The Court of Appeals unanimously affirmed the judgment appealed from; and a judgment of affirmance was entered on March 16, 1949. On April 5, 1949, the Court of Appeals denied petitioner's application for a rehearing.

Respondent contends that none of the grounds recognized by this Court as a proper basis for the issuance of a writ of certiorari exists herein; that the controversy between the parties is one wherein petitioner is seeking, upon purely technical and altogether insubstantial grounds, to avoid fulfillment of its contract obligation; and that no question of general public interest is involved herein.

The facts as set forth in the petition for the writ of certiorari, and in the brief in support thereof, are so inaccurately and inadequately presented that it is necessary to include herein a more complete statement thereof.

The Facts.

The action is brought to recover the sum of $150,000, being the unpaid balance upon a contract between respondent and the petitioner, The Grayson Shops Incorporated (of California), name changed to Grayson-Robinson Stores, Inc. (hereinafter referred to as "Grayson") whereby respondent agreed to sell and assign to petitioner and petitioner agreed to purchase and accept an assignment of all respondent's right, title and interest in and to a certain contract for the employment of respondent made between respondent and S. Klein on the Square, Inc.

S. Klein on the Square, Inc., a New York corporation, owns and operates an extensive business in women's apparel and accessories at Union Square and Fourteenth Street, in New York City.

The business was originated and developed by S. Klein, who died in November, 1942. S. Klein left him surviving three daughters and a number of brothers and sisters and other relatives.

In 1928 respondent married the eldest daughter of S. Klein. In 1933 respondent was admitted to practice law

in the State of New York; and he was thereafter consulted from time to time by S. Klein in connection with the latter's legal problems (f. 133).*

For some time after the death of S. Klein his executors continued to operate the business. In order to save the business for the family respondent was active during that period in negotiating for its purchase on their behalf, from the executors.

On April 15, 1944, as a result of such negotiations, an agreement was entered into, pursuant to an offer made to the executors by respondent (on behalf of the children and brothers and sisters of S. Klein) and approved by the Surrogate, whereby the business was acquired by a corporation organized under the name of S. Klein on the Square, Inc., of which all the securities (consisting of debenture bonds, preferred stock, and common stock) were subscribed for and issued to the children and other relatives of S. Klein and a few other interested persons (f. 231).

The agreement (Plaintiff's Exhibit 1 for Identification), of which paragraph 10 was read in evidence, provided in said paragraph that respondent "be and he is hereby hired, nominated, engaged, designated and/or elected president and executive director of said corporation for a period of not less than five years from date, and he shall receive a net salary of not less than $25,000 per year for such service, plus 5 per cent. of the net profits before taxes in each year to be determined at the end of each fiscal year" (ff. 136-138, 148-149).

On December 18, 1944, this agreement of employment between respondent and S. Klein on the Square, Inc. (hereinafter referred to as "Klein") was modified by resolution of the board of directors, approved by vote of all the

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* References (unless otherwise indicated) are to folio numbers in the record.

stockholders, to provide that respondents salary as president should be $30,000 per year, plus 5 per cent. of the net profits in each year before taxes, and that his employment should be for a period of five years from April 15, 1944; a letter to that effect, signed by Klein and accepted by respondent, was received in evidence as Plaintiff's Exhibit 2 (ff. 143, 449).

Respondent entered upon his duties as president and executive director of Klein on April 17, 1944; and continued in such employment, under his said agreement, until the business was taken over by petitioner on February 28, 1946 (f. 139).

For some time prior to February, 1946, petitioner (a California corporation operating a number of retail shops in California and elsewhere) was eager to acquire the ownership and control of Klein, in New York City (f. 186).

On February 2, 1946, an agreement was entered into by petitioner with the respondent and one Alvin Handmacher (who also had married a daughter of S. Klein), whereby petitioner agreed to purchase all the outstanding securities of Klein for the sum of two and a half million dollars ($2,500,000). This agreement was approved and subscribed to by all the holders (with certain minor exceptions) of the said securities. The agreement was signed on behalf of petitioner by H. Kuchai, its president (Plaintiff's Exhibit 3; also Exhibit 7; ff. 145-147, 174-176).

On February 2, 1946, simultaneously with the making of said last mentioned agreement, respondent and petitioner entered into a contract whereby respondent agreed that in the event of a closing under the said agreement for the sale and purchase of said securities, he would:

> (a) sell and assign to petitioner all his right, title, equity and interest in and to the said agreement of

employment, dated April 15, 1944, between respondent and Klein;

(b) resign as an officer and director of Klein and its subsidiaries; and

(c) refrain, for a period of six years from the date of such closing, from assuming a position of general executive duties and responsibilities with any ladies' apparel department store in the Borough of Manhattan, City of New York.

The petitioner therein agreed that if such closing should take place, it would simultaneously therewith:

(a) accept the said assignment by respondent and accept other written instruments evidencing respondent's resignation and agreement not to compete as aforesaid; and

(b) pay and agree to pay to respondent the sum of $200,000 as follows: $50,000 simultaneously with such closing; $30,000 on January 2, 1947; $30,000 on January 2, 1948; $30,000 on January 2, 1949; $30,000 on January 2, 1950; and $30,000 on January 2, 1951.

It was further agreed therein that in the event of petitioner's default in paying any one of said installments when due and the continuation of such default for a period of 10 days, respondent might, at his option, declare the entire unpaid installments immediately due and payable (Plaintiff's Exhibit 4, ff. 454-459).

The said agreement for the sale and purchase of the securities of Klein granted permission to petitioner to examine, by its attorneys, accountants and other representatives, all records, documents and property of Klein and its subsidiaries; and pursuant thereto an inventory was taken by petitioner's accountants; petitioner's auditors were in touch with the auditors of Klein and examined its

books (f. 350); the minute books and various documents required by petitioner were delivered to it on February 8, 1946; and thereafter, by letter dated February 12, 1946, petitioner advised respondent and Handmacher that petitioner was "prepared to consummate the purchase contemplated by agreement among us dated February 2, 1946" (Plaintiff's Exhibit 12, f. 485).

The closing under the said agreement for the sale of the securities of Klein to petitioner was had on February 28, 1946. The agreement called for the delivery to petitioner of all the outstanding stock of Klein; actually only about 94 per cent. thereof was delivered; but Milton Diamond, who was petitioner's secretary, general counsel and director, testified, in answer to the Court's question, that petitioner was content to take the 94 per cent. (f. 362).

At the same time with the closing of the agreement for the sale of said securities, petitioner paid to respondent the sum of $50,000, representing the first payment due under the agreement with respondent dated February 2, 1946; respondent assigned to petitioner all his right, title, equity, interest and benefits accruing to him under his said employment contract with Klein; and respondent specifically agreed to refrain for a period of six years from assuming a position of general executive duties and responsibilities with any ladies' apparel department store in the Borough of Manhattan, City of New York (Plaintiff's Exhibit 5, ff. 460-463).

Respondent testified that his contract to sell to Grayson his employment agreement with Klein (Plaintiff's Exhibit 4), was prepared by Poletti, Diamond, Rabin, Freidin & Mackay, the attorneys for Grayson (f. 154); and that the assignment to Grayson of respondent's rights under the said employment agreement (Plaintiff's Exhibit 5) was prepared by the same attorneys (f. 155).

Respondent further testified that on February 28, 1946, he resigned as an officer and director of Klein and of its subsidiary companies (f. 155); that since February 28, 1946, he had not engaged, directly or indirectly, in any business relating to ladies' apparel department stores in the City of New York or elsewhere (ff. 156-157); that the payment due on January 2, 1947, under respondent's agreement with petitioner, was not made, and on January 3, 1947, respondent wrote a letter reminding petitioner thereof (Plaintiff's Exhibit 6); but the said payment was not made and no further payment was made (f. 157).

On January 23, 1947, more than ten days after said installment became due, respondent commenced this action; and in his complaint elected to declare the entire amount of $150,000 immediately due and payable under his agreement with petitioner (ff. 17, 159).

Petitioner, in its second amended answer, admitted the making of its contract, dated February 2, 1946, for the purchase of the securities of Klein, and the making of its contract with respondent, dated February 2, 1946, to purchase respondent's interest in his employment contract; and admitted that a closing was had under the said contract for the purchase of securities; that at the time of said closing petitioner paid respondent the sum of $50,000; and that it did not pay respondent the sum of $30,000 on January 2, 1947 (ff. 26-27).

The said amended answer also pleaded certain alleged affirmative defenses and counterclaims. The first so-called defense (relating to claims for certain alleged unpaid items of taxes of Klein) was palpably insufficient in law and was withdrawn by petitioner at the opening of the trial (ff. 129-130).

The other alleged defenses and counterclaims were so far insufficient that the Trial Judge indicated a disposition

to dismiss them upon the petitioner's opening (ff. 96-97); but on petitioner's insistence, he finally decided to hear the evidence, saying to petitioner's counsel "I will let you try your case, but I am fearful of it" (f. 129).

The fears of the learned Trial Judge in this respect were fully justified; for the proof wholly failed to support or sustain any of the alleged defenses and counterclaims; and the Court properly directed a verdict for respondent at the close of the evidence.

From the judgment thereupon entered petitioner appealed to the United States Court of Appeals for the Second Circuit. The Court of Appeals unanimously affirmed the judgment in an opinion wherein it said:

> "We think the trial judge correctly decided that, in support of these defenses, there was not sufficient evidence to go to the jury" (R. p. 195).

The testimony, so far as it is material to the points in issue, is set forth below.

POINTS.

I.

The trial court properly directed a verdict in favor of respondent.

(1)

The rule governing the direction of a verdict has been frequently stated by this Court (*Small Company* v. *Lamborn & Co.*, 267 U. S. 248, 254; *Empire State Cattle Co.* v. *Atchison, T. & S. F. R. Co.*, 210 U. S. 1, 10; *McGuire* v. *Blount*, 199 U. S. 142, 148).

In the frequently cited case of *Small Company* v. *Lamborn & Co., supra* (where the defendant buyer of merchandise endeavored to escape liability on its contract, upon technical grounds, after there had been a fall in the market price of the merchandise), in affirming a judgment for plaintiff entered on a directed verdict, the Court said, in an opinion by Mr. Justice Van Devanter (citing many cases):

> "The rule for testing the direction of a verdict, as often has been held, is that where the evidence is undisputed, or of such conclusive character that if a verdict were returned for one party, whether plaintiff or defendant, it would have to be set aside in the exercise of a sound judicial discretion, *a verdict may and should be directed* for the other party. The view that a scintilla or *modicum of conflicting evidence, irrespective of the character and measure of that to which it is opposed,* necessarily requires a submission to the jury has met with express disapproval in this jurisdiction, as in many others" (Italics added).

In *McGuire* v. *Blount,* 199 U. S. 142, 148, the applicable principle is stated as follows:

> "It is strenuously urged that, whatever the merits of the controversy, there was sufficient proof to require a trial judge to submit the case to a jury; but no rule is better established in this court than that which permits a presiding judge to direct a verdict in favor of one of the parties when the testimony and all the inferences which the jury could justifiably draw therefrom would be insufficient to support a different verdict. It is clear that where the court would be bound to set aside a verdict for want of testimony to support it, it may direct a finding in the first instance, and not await the enforcement of its view by granting a new trial."

In *Pennsylvania R. Co.* v. *Chamberlain*, 288 U. S. 333, 343, the Court said:

> "We think, therefore, that the trial court was right in withdrawing the case from the jury. It repeatedly has been held by this court that before evidence may be left to the jury, 'there is a preliminary question for the judge, not whether there is literally no evidence, but whether there is any upon which a jury can properly proceed to find a verdict for the party producing it, upon whom the onus of proof is imposed.' *Pleasants* v. *Fant*, 22 Wall. 116, 120. And where the evidence is 'so overwhelmingly on one side as to leave no room to doubt what the fact is, the court should give a peremptory instruction to the jury.' *Gunning* v. *Cooley*, 281 U. S. 90, 94. *Patton* v. *Texas & P. R. Co.*, 179 U. S. 658, 660. The rule is settled for the federal courts, and for many of the state courts, that whenever in the trial of a civil case the evidence is clearly such that if a verdict were rendered for one of the parties the other would be entitled to a new trial, it is the duty of the judge to direct the jury to find according to the views of the court. Such a practice, this court has said, not only saves time and expense, but 'gives scientific certainty to the law in its application to the facts and promotes the ends of justice.' *Bowditch* v. *Boston*, 101 U. S. 16, 18."

In *Foye Lumber Co.* v. *Pennsylvania R. Co.* (8th Cir.) 10 F. (2d) 437, 438, it was said:

> "It is the duty of the trial court to direct a verdict at the close of the trial in two classes of cases: (1) That class in which the evidence is undisputed; and (2) that class in which the evidence is conflicting, but of so conclusive a character that the court, in the exercise of a sound judicial discretion, would set aside a verdict in opposition to it. And when the

trial court has directed a verdict upon the latter ground, the appellate court may not lawfully reverse the judgment founded upon it, unless upon a consideration of the evidence it is convinced that it was not of such a conclusive character that the court below, in the exercise of a sound judicial discretion, should not have sustained a verdict in the opposite direction."

The case last cited was recently followed in *Grinnell Co.* v. *Miller* (3rd Cir.) 150 F. 2d 345, 355, where, although there was conflicting evidence, a judgment on a directed verdict was affirmed; the Court said:

> "Otherwise stated, if the evidence is of such conclusive character that a verdict returned for one party, whether plaintiff or defendant, would have to be set aside in the exercise of a sound judicial discretion, the trial court should withdraw the case from the jury and direct a verdict for the other party."

In *Wheeler* v. *Fidelity & Deposit Co.* (8th Cir.) 63 F. (2d) 562, 564, the Court said:

> "While it is a general rule that, in considering a motion for a directed verdict, the evidence produced by the party against whom the verdict has been directed should be considered in its most favorable light, yet, after all, there must be substantial evidence in support of an issue in order to entitle a litigant to have that issue submitted to a jury. And, even where the evidence is conflicting, if it is of so conclusive a character that the court, in the exercise of sound judicial discretion, would set aside a verdict in opposition to it, then it is the duty of the court to direct a verdict."

Applying the rule, as set forth in the above authorities, to the instant case, it is quite evident, upon an analysis of

the evidence, that a verdict was properly directed for the respondent.

The language of the Court in *Houston Oil Co.* v. *Goodrich*, 245 U. S. 440, 441, is applicable to the case at bar, as follows:

> "The propriety of submitting these matters depended essentially upon an appreciation of the evidence. Having heard it all, the trial court concluded there was not enough in support of any one of petitioners' above-stated claims to warrant a finding in their favor, and the circuit court of appeals reached the same result. 141 C. C. A. 264, 226 Fed. 434.
>
> The record discloses no sufficient reason within the rule long observed why we should review the judgment below. *Forsyth* v. *Hammond*, 166 U. S. 506."

(2)

The instant case is, in its essentials, a simple one; though the petitioner (in its pleading, upon the trial, upon the appeal, and in its petition and brief herein) has diligently endeavored to confuse and obscure the issues.

The petitioner Grayson was (according to the uncontroverted testimony) eager to acquire ownership of Klein (f. 186).

The method whereby this was to be accomplished was by the purchase of all the outstanding securities of Klein. Petitioner did in fact acquire all the securities with the exception of a small percentage which petitioner was content to waive (f. 362).

The purchase by petitioner of the securities of Klein did not, of course, affect the existing and outstanding contracts and obligations of Klein—they remained unaffected by the change of ownership of the stock, except in so far as

they were terminated or otherwise disposed of by express agreement.

Among the existing and outstanding contracts was respondent's five-year employment agreement. It had approximately three and one-quarter years to run. It had been fully performed by both parties. No claim is made by petitioner that Klein ever expressed any dissatisfaction with the contract or with respondent's performance thereof. Under respondent's management the business had prospered to the extent that petitioner was anxious to obtain the business and was willing to pay $2,500,000 for it. Respondent was satisfied with his contract; he would doubtless have preferred to have things remain as they were—the business was prosperous, he had a good contract, and his salary and position were secure.

Petitioner, however, wanted the respondent out—if petitioner was to own and operate the business, it wanted its own management (f. 103). Although Diamond, petitioner's secretary, director and general counsel, was evasive in his answers to questions whether petitioner wanted to get the respondent out (ff. 372-374), he finally admitted that such was the fact when he testified, in answer to the Court's question:

> "Q. In your brief you wrote this: 'Because the defendant did not want Stone in the management in any capacity including that of an executive and did not want any possible assignee of his to interfere, it agreed to purchase his rights for $200,000.' That is a correct statement? A. I am sure it must be, yes, your Honor" (f. 375).

The negotiations for the sale to petitioner of the securities of Klein did not originate with respondent—they were worked out by Handmacher (admittedly unfriendly to re-

spondent) and Kuchai, petitioner's president, together with Diamond. Handmacher testified that he and Kuchai were next door neighbors in Harrison, N. Y.; that it was not until he and Kuchai had practically worked out a price that they approached the respondent; and that he did not want respondent to know anything at all about the matter until the offer was substantially formulated (f. 395). The offer was made in Kuchai's letter to Handmacher, dated January 21, 1946, which was prepared in Diamond's office and pursuant to his instructions (Plaintiff's Exhibit 12, ff. 329-331). It is in substance the same as the contract which followed for the sale of the securities.

It was not until Sunday, January 27, 1946, that respondent was called into a conference at Diamond's home in Connecticut—Diamond testified that it was then he met respondent for the first time (f. 328). Respondent was called in only to get his consent (f. 181). The question of respondent's contract came up. Respondent was (as Diamond testified) an important factor in the sale of the securities; he was a substantial owner and he had a contract (f. 331); respondent, with other security holders, had certain priorities before securities could be sold to outsiders (ff. 333-334); and respondent was unwilling to sell unless a satisfactory arrangement was made with respect to his contract (ff. 330-331, 336).

No question was then raised as to the validity of respondent's contract. There was some dickering as to price; there was (as respondent testified) never any question about what his contract was, nor were any representations made by him; all that Diamond said to respondent was that he wanted to buy the contract for less money—respondent had told Diamond he wanted $350,000 (f. 187). The price agreed upon was $200,000; it was to be paid $50,000 upon the closing and the balance in five annual installments of $30,000

each, with a provision for respondent's resignation and agreement not to compete.

Respondent's contract with petitioner (Plaintiff's Exhibit 4) was prepared accordingly, at the same time with the contract for the sale of the securities (Plaintiff's Exhibit 3). Both contracts were prepared in Diamond's office, in accordance with his instructions, and after he had stated what they were to contain (ff. 339-342). Performance of petitioner's contract with respondent was made conditional upon the closing of the contract for the sale of the securities. The two contracts were interrelated and interdependent; they formed parts of a single integrated transaction; they were simultaneously signed and were to be (and were in fact) simultaneously closed. Both agreements—the entire set of simultaneous instruments—were printed by petitioner and bound up by it in one paper under one cover (Plaintiff's Exhibit 7, ff. 174-176).

Diamond testified with respect to an alleged oral representation or warranty which he said had been made by respondent prior to the making of his contract with petitioner; but Diamond's testimony in this respect (as hereinafter pointed out) was *too indefinite to be of any significance or value.* The fact is uncontroverted that petitioner, through its attorneys, accountants and auditors, fully informed itself before the closing with respect to all phases of the transaction. It is significant that while the contract for the sale of the securities contains many express warranties and representations *none was inserted in respondent's contract,* prepared by the same attorneys at the same time.

On the closing of the contract for the securities, the sum of $50,000 was paid by petitioner to respondent; and petitioner received and accepted the assignment of respondent's employment contract, together with his resignation and agreement not to compete.

Petitioner thus obtained everything that it wanted and that it had set out to obtain—it had the business and it had the respondent out.

Thereupon, having obtained all that it wanted, petitioner forthwith proceeded to repudiate its contract with respondent; it determined to pay him nothing more—rather it would take a chance with a lawsuit.

Obviously, there is nothing in petitioner's conduct or present position that merits consideration in equity or good conscience. Nor is there any legal basis for petitioner's position.

Upon the trial respondent established (by proof not controverted in any substantial respect) every element of his cause of action. The making of his contract with petitioner was admitted in the amended answer. In the absence of any showing of a meritorious defense (of which there was no proof whatever) respondent was entitled to the directed verdict and judgment thereon.

Petitioner set up numerous technical objections and alleged defenses, some of which it attempted to support with proof upon the trial; but (as hereinafter more fully appears) they were shown to be wholly without merit and were wholly unsupported by the evidence. That was the view taken by the Trial Judge; and his ruling to that effect has been unanimously affirmed by the Court of Appeals.

(3)

In the first alleged defense set forth in its second amended answer petitioner pleaded an alleged breach of a warranty not contained in the contract sued upon herein, but in the contract (simultaneously executed) for the sale to petitioner of the securities of Klein. Upon the trial petitioner withdrew this alleged first defense. It is only

referred to herein as showing petitioner's understanding and realization that the two contracts formed parts of but a single transaction—that both were essential to make the complete agreement (f. 129).

In the "second defense and first counterclaim" contained in petitioner's second amended answer, it is alleged that respondent represented and warranted to petitioner that his contract, at the time of the assignment of his rights thereunder, was a "valid and subsisting contract, free from any and all defenses or grounds for termination thereof"; that it was not a valid and subsisting contract for the alleged reasons that during the term of the contract respondent (a) without the knowledge and consent of Klein, had "converted to his own use certain goods, wares and merchandise which were the property" of the corporation; (b) caused employees of the corporation, without its knowledge or consent, to render personal services and to supply material and merchandise for respondent's own use, all at the expense and cost of the corporation and without compensating it therefor; and (c) secretly dealt with persons, firms and corporations engaged in selling merchandise to the corporation, and secretly received and accepted for his own use and benefit rebates and allowances from such persons, firms and corporations then engaged in business dealings with the said corporation (ff. 38-40).

It is nowhere stated in the said alleged defense that *Klein* (the other party to respondent's contract of employment) elected at any time or for any reason to terminate its contract with the respondent; or that Klein did not fully recognize and carry out its said contract up to the date of respondent's assignment of his rights therein to the petitioner.

If it be assumed that there existed any of the alleged "grounds for termination" of the contract set forth in said defense (of which, however, there is no proof in the case whatsoever) the most that can be said is that it might have given *Klein* a right (which was never exercised) to terminate the respondent's contract.

Petitioner, although it was the purchaser of the outstanding securities of Klein and the holder of 94 per cent of its stock, could not itself (*as a stockholder*) elect to terminate and avoid the contract made between respondent and the Klein corporation.

Petitioner is not the successor in interest of Klein—petitioner controls Klein solely by reason of its purchase of substantially all the outstanding securities of Klein.

The important fact (which must not be lost sight of) is that respondent's contract of employment was with Klein; if any possible reason existed which would justify the termination or rescission of the respondent's contract, Klein (since it still owns and operates the business and has never assigned or transferred its rights or interests therein to the petitioner) would have *the sole right* to terminate or rescind the contract.

There is no allegation in the amended answer, and there was no proof upon the trial, that Klein ever exercised any alleged right to terminate or rescind the respondent's contract, either before respondent assigned his interest therein to the petitioner, or even after the said assignment and while petitioner was in control of Klein.

In the absence of such an allegation (and proof thereof) the alleged defense and counterclaim was *fatally defective and wholly insufficient as a matter of law* to constitute a defense or counterclaim. The same is true of the other alleged defenses contained in the said amended answer.

This was the view taken by the learned Trial Judge when he indicated that he was disposed to grant respondent's motion to dismiss the defenses on the petitioner's opening (ff. 97, 129).

In the colloquy between the Court and petitioner's counsel the Court said, "So certainly the [employment] contract when made was a perfectly valid and binding agreement" (f. 102); "You are not suggesting that the contract had been canceled before it was delivered" (f. 107); "You [Grayson] could not have fired him until you came into control of the corporation and if you did *it would have been S. Klein that terminated the contract, not Grayson*" (f. 108); "You got it [respondent's resignation] peacefully and peaceably. You paid a price for it. Why shouldn't you pay for it. *I don't see that you made out a case*" (f. 110); "How you put yourself in the shoes of S. Klein here I don't know, • • • The most that I can see, S. Klein had the option at that time, at most, S. Klein had the power to assert a defense to that contract. That is all. *But it did not exercise it, had not exercised it*" (f. 111); and that the petitioner, *as a stockholder,* could not exercise the right which the Klein corporation did not elect to exercise (ff. 112, 116).

The Court might properly have granted the motion to dismiss the alleged defenses on petitioner's opening and directed judgment for respondent on the admitted allegations of the complaint (ff. 97-98). Instead of doing so, the Court gave petitioner an opportunity to prove its case (f. 129).

Petitioner's proofs wholly failed to support the allegations of its pleading; petitioner's case, at its conclusion, was not only weaker than it had appeared on the opening, but it then appeared that *petitioner had failed completely* to establish his alleged defenses. The Trial Court, therefore,

properly granted respondents motion for a directed verdict; and the judgment entered thereon was properly affirmed by the Court of Appeals.

(4)

None of the alleged "infirmities" or "grounds for termination" of the respondents contract (as set forth in said "second defense and first counterclaim") did in fact exist.

For the most part petitioner made no attempt to prove the matters specifically pleaded in the alleged defense.

(a) Thus, with respect to the *alleged secret rebates* and allowances (sometimes termed *"kick-backs"*) which it is alleged in said defense the respondent secretly received from persons, firms or corporations having dealings with Klein, there was not the slightest attempt on the part of the petitioner to prove, or to offer any proof, in support thereof.

Having recklessly made this scandalous charge against the respondent in its amended answer, petitioner conveniently forgot all about it, and *wholly ignored it upon the trial.*

(b) In like manner petitioner made no attempt to prove its allegation in said defense that respondent caused employees of the corporation, without its knowledge or consent, to render personal services and to supply materials and merchandise for respondent's own use without compensating the corporation therefor. The case is wholly devoid of any proof to sustain that allegation.

(c) Nor was there any proof offered by defendant in support of its charge (as set forth in said second alleged defense) that respondent, without the knowledge and con-

sent of Klein, *"converted to his own use"* goods, wares and merchandise which were the property of the corporation.

There is no proof whatever that respondent ever received or obtained any merchandise of Klein which was not (a) either paid for by him or (b) included in the charges upon the books of the corporation which were cancelled (by resolution of the directors and stockholders of Klein) prior to the closing of the transaction with the petitioner—which cancellation was expressly consented to by petitioner in its letter to respondent dated February 9, 1946, wherein petitioner said:

> "We do hereby acknowledge that we have been advised and do hereby consent to the cancellation of certain charges on the books of account of S. Klein On The Square, Inc., in the name of Herbert D. Stone, in the sum of $4,394.49 at cost, or $5,359.13 at ticket price" (Plff's Ex. 9, f. 470).

Apparently it is petitioner's contention that merchandise so charged to respondent on the books of the corporation could be deemed "converted" by respondent within the meaning of the allegation in the amended answer. Of course, this is not so. There is no dispute that no merchandise was taken by respondent unless it was either paid for by him or charged to his account (ff. 226-227). Manifestly there was no *"conversion"* by respondent of merchandise which was fully and accurately entered upon the books of the corporation and charged against respondent thereon—there would thereby be created an *indebtedness* in favor of the corporation, but that would afford no basis for avoiding the contract. The amount of such indebtedness, if not otherwise paid, might be offset against moneys subsequently due and payable to respondent—for one thing, as against his percentage of the net profits payable under his employment

agreement at the end of the fiscal year—a practice which was apparently followed on other occasions (f. 307).

(d) With respect to the cancellation of the charges for merchandise against respondent on the books of Klein, respondent testified that he told Diamond about them—part of the consideration for the sale to petitioner of respondent's employment contract was petitioner's consent to the cancellation of these charges; and that it was Diamond who suggested the adoption by the directors and stockholders of resolutions approving such cancellation (f. 222). Diamond denied this conversation with respondent (f. 322); but admittedly it was he who was "negotiating this deal" (f. 339)—he was in frequent contact with Kuchai and he admitted Kuchai told him that as a result of conversations with respondent, petitioner had agreed to the cancellation of the charges against respondent; and that Kuchai might have told him that such cancellation had been approved by the directors and stockholders of Klein (f. 357).

The minutes (Defendant's Exhibits B and C) recite that respondent informed the directors and stockholders that the charges were for goods distributed to various persons for the general good and welfare of the firm (ff. 507, 510); whereas respondent testified that while some of the goods were distributed for the good of the firm, they were preponderantly purchases for himself, his wife and children (f. 225); he told that to the directors, and they knew it (ff. 222-223); and he told it to the stockholders (f. 225). Respondent said the minutes did not accurately recite what he told the directors and stockholders (f. 223). It was Diamond who suggested (as respondent testified) not only that resolutions should be drawn, but he indicated the way they should be drawn—"the minutes were set forth as desired by Mr. Diamond" (f. 223). Respondent testified

that he did not state to Kuchai, in words or substance, that said goods had been distributed for the good and welfare of the corporation (f. 221), and his testimony in this respect is not denied—significantly, Kuchai (though petitioner's president) was not called by petitioner to take the stand.

Petitioner contended below that there were defects in the adoption of the said resolutions with respect to quorum and voting which rendered the resolutions invalid. As was brought out by the Court's questioning, however, Klein was a closely held corporation—*substantially a family corporation*—where compliance with formal technical requirements (that might otherwise be insisted upon) were not strictly essential (*Gerard* v. *Empire Square Realty Co.*, 195 App. Div. 244, 249, and cases there cited). Thus it appears (in the course of petitioner's direct examination of respondent):

> "By the Court:
>
> Q. Let me ask one question. Were all the stockholders of S. Klein before this transaction all members of the S. Klein family? A. Yes.
>
> Q. Or employees? A. Yes.
>
> Q. It was not a publicly held corporation? A. No.
>
> Q. That was a private enterprise? A. Yes.
>
> Q. How many stockholders were there? A. I would say about 30.
>
> Q. Mostly members of the family? A. Predominantly members of the family and a few outside interests who made up sufficient funds to acquire the business from the executors pursuant to the Surrogate's decree" (ff. 230-231).

Petitioner's counsel asked respondent if there were not approximately 65 stockholders (instead of about 30, as respondent had testified) but reference to the list of stockholders printed by petitioner as a part of Plaintiff's Exhibit

7 (at page 11 thereof) shows that there were (excluding duplications) approximately 38—most of whom (it is not disputed) were in some way related to S. Klein or were employees of Klein.

Moreover, the books containing the minutes of the meetings of the directors and stockholders of Klein, with other documents requested by petitioner, were delivered to petitioner's attorneys for full and complete inspection and examination on February 8, 1946 (ff. 354, 481-483, Plaintiff's Exhibit 11). Diamond testified, in answer to the Court's questions:

> "By the Court:
>
> Q. So that the members of your staff could look at them? A. Yes.
>
> Q. And assure themselves that everything was in apple pie condition? A. Yes.
>
> Q. You were buying a two and a half million dollar property and you were representing your client and you were going to see that everything was all right? A. Yes, sir (ff. 351-352).

Diamond testified that Adler, his associate who principally handled the matter in his office (and who was not called as a witness) told him that he had examined the minute books (f. 359); and Diamond further testified:

> "By the Court:
>
> Q. You wanted to be sure that you were getting a satisfactory deal. You did not want to buy a lawsuit, and you examined the minute books with that end in view. A. Yes, sir.
>
> Q. And he [Adler] made no objection or raised any question? A. He raised questions at various times during the examination, but I don't remember on what subjects they were.
>
> Q. But they were resolved? A. But they were resolved" (f. 360).

The closing did not take place until February 28, 1946; so that *for 20 days* petitioner's attorneys had the minute books in their possession and subject to their examination.

They had the fullest opportunity prior to closing (if they were not satisfied with the minutes or the proceedings as recorded therein) to make objections (as to quorum or otherwise) and cause corrections therein to be made or further proceedings to be had. In fact, it was on February 12th, *four days* after delivery of the minutes and documents to petitioner's attorneys, that Diamond wrote respondent that they were prepared to consummate the purchase (Plaintiff's Exhibit 12, f. 485). Respondent testified, also in response to the Court's questions:

"By the Court:

Q. Who represented Grayson at that closing? A. Poletti, Diamond, Rabin.

Q. Who in particular; which lawyer? A. Mr. Diamond.

Q. He examined all of this corporate business? A. That is right.

Q. He expressed himself as being content with it? A. Yes.

Q. And authorized his client to pay the money? A. That is right; and they did pay" (ff. 216-217).

(5)

Petitioner having failed to show that respondent had converted to his own use *any merchandise* of Klein (as alleged in the said defense in the amended answer) it endeavored to prove upon the trial that respondent had taken *other property* (nowhere referred to in the said defense) belonging to the corporation, and that such taking was a ground for termination by Klein of the employment contract; but in this respect also petitioner's efforts were not only *wholly unsuccessful*, but they bordered on the ludicrous.

(a) For one thing petitioner tried to show that respondent had taken certain items of furnishings from the club house on 15th Street, which had been maintained by S. Klein personally (apart from the business) for the benefit of his employees. It appeared, however (and it is undisputed) that in addition to the furniture and equipment of the club house (which had been sold by the executors to the Klein corporation, f. 269) there had been brought into the club house (prior to the death of S. Klein) certain personal effects belonging to S. Klein which under his will were given directly to his children—it was only these personal effects of S. Klein which respondent caused to be moved away and which he then distributed to his wife's sisters (ff. 271-272).

Certain other items of property about which petitioner's counsel inquired were (according to the undisputed testimony) articles which respondent had personally purchased from auctioneers at 11th Street and University Place and had caused to be delivered at the Klein driveway on 13th Street; they were there picked up for delivery to respondent by the Weisberger Moving & Storage Company; they were never in the club house—they were the articles included in the list read by petitioner's counsel at folios 234-236.

The club house furniture and equipment bought from the executors by Klein were distributed in different parts of the Klein building—some were put in respondent's office as president; they were left there by respondent upon his resignation (ff. 240-241).

There were certain other articles of furniture in respondent's office which belonged to him and which he had brought there from his home; they were all his personal property and he removed them (f. 242). He told Diamond of this furniture and Diamond said "Take it out" (f. 249).

Petitioner's letter of February 9, 1946 (Plaintiff's Exhibit 9) listed these articles of furniture belonging to respondent and consented to his removing them (ff. 471-472). There were a bookcase and sets of books in the club house, which were purchased by Klein from the executors; they were not taken to respondent's private office—they were taken down to the employee's lounge in the main Klein building for the use of the employees (f. 245). Nat Cohen, about whom petitioner's counsel inquired and who was a clerk at Klein's, did not take (it is undisputed) any books away for the respondent (f. 247); he took only certain cartons containing respondent's personal stationery and his legal papers (f. 247). When respondent moved down to Klein's he had brought with him his own typewriter and law furniture—when respondent moved from Klein's, he removed this typewriter and furniture (f. 249).

(b) Petitioner's effort in this connection resolved itself finally into nothing more than an attempt to show that respondent had converted a *radio* (upon which petitioner placed great stress in its brief in the Court below and upon this application); in this attempt also petitioner was wholly unsuccessful. The value of this used radio does not appear; nor whether its taking, as alleged by petitioner (if true) was a matter of any moment. The testimony for petitioner in this respect was that of one Lauterbach (employed at Klein's as an engineer); he testified that one day as he was walking through the club house with respondent, he remarked to respondent that "some son-of-a-bitch even took that radio out of the wall," whereupon respondent laughed and said he took it (ff. 282-283). Lauterbach first said this conversation took place in the summer of 1945 (f. 281); then he said, on cross examination, that he could not say whether it was 1945 or 1946—it was in the summer

months (f. 285); on his examination before trial he had testified that it was in the summer of 1944 (f. 287)—which would have been before the making of respondent's supplemental contract of employment whereby in December, 1944, Klein (by unanimous vote of its directors and stockholders) increased respondent's salary. Respondent denied that any such conversation as Lauterbach testified to ever took place (f. 245); but even if it did, respondent's facetious or *laughing remark* (as Lauterbach described it) falls far short of proving that respondent *converted* the radio—assuming that respondent did take out the radio (of which there was no proof), for all that appears (and in consonance with Lauterbach's testimony) respondent may have taken it over to the Klein building and left it with the other articles in the employees' lounge or elsewhere for the use of the employees.

The insignificance of this radio item (in view of the fact that the parties were dealing with contracts involving $2,500,000 and $200,000 respectively) does not warrant the discussion devoted to it or the emphasis placed upon it by petitioner. Still less important is the petitioner's questioning of respondent with respect to the dictionary and stand (f. 276). Petitioner tried to show that respondent had told Lauterbach he had taken a dictionary and stand. Respondent denied any such conversation; and Lauterbach (though examined as a witness by petitioner) was not asked about it and made no mention of it. Respondent testified that the dictionary and stand were removed from the club house to the employees' lounge in the main Klein building—he did not personally take the dictionary and stand (ff. 276-277). It is only referred to here as indicating petitioner's desperate effort to find in the record *some object of criticism—no matter how slight or petty, or how wholly unsupported by proof.*

That part of the opinion of Vann, J., in *Callanan* v. *K. A. C. & L. C. R. R. Co.*, 199 N. Y. 268, 284 (cited by petitioner in the Court below as the leading case, which was quoted at length in the petitioner's brief on the appeal) may well be applied to petitioner's efforts to spell out a case for rescission herein, as follows:

> "It is not permitted *for a slight, casual or technical breach,* but, as a general rule, only for such as are material and willful, or if not willful, *so substantial and fundamental* as to strongly tend to defeat the objects of the parties in making the contract." (Italics added).

(6)

Petitioner, as a last resort, attempted to show that something in connection with the checks for $50,000 and $13,000 (nowhere referred to in any of the alleged defenses in the amended answer) might have afforded *Klein* a right (which it never exercised) to terminate respondent's employment contract. This attempt, also, was wholly unsuccessful.

(a) Briefly, the facts with respect to the $50,000 check are as follows: In order that respondent's efforts to save the business for the family of S. Klein should be successful, it was necessary to raise and pay to the executors before April 15, 1944, the sum of $1,007,000.

To make up the total of this large amount and to enable the deal to be put through (for the benefit of the family, relatives and employees) respondent borrowed from the Marine Midland Trust Company (on his own and his wife's signatures) $150,000 on a four months' note (ff. 252-253, 293, 296).

Respondent paid $50,000 on account of the note in May, 1944, leaving a balance of $100,000. In August (when the

note became due) the bank called for a further part payment; respondent took it up with members of the executive committee and as a result of talking with them, on August 11, 1944 respondent drew a corporate check for $50,000 to his own order, deposited it to his account, and paid the amount to the bank (f. 254). *Nineteen days later,* on August 30, 1944, the loan was repaid. In order to repay the loan respondent borrowed $50,000 from two of the directors of Klein (f. 254).

The loan was recorded on the books of the corporation—respondent advised the bookkeeper to make a note of it, and the accountants and auditors of the corporation were fully advised of it (ff. 254, 256). The check stub showed that the check was made payable to respondent, and had a notation thereon "Even Exchange" (ff. 257-526). The whole transaction was disclosed on the books—there was nothing concealed or secret about it. Handmacher, who was a member of the executive committee, testified that he did not recall any conversation with respondent about the withdrawal of $50,000 (f. 384); and that he first learned of the withdrawal when he was subpoenaed to testify at the trial (f. 386). On cross-examination, however, when Handmacher was asked if he knew that Mr. Berkeley and Mr. Rosenblum (two of the members of the executive committee) each loaned respondent $25,000 to repay the money borrowed from the company, he answered that he knew respondent had borrowed some money, but he did not know from whom —*he knew in 1944* that respondent had borrowed some money, but he said he did not know he had borrowed the money from Rosenblum and Berkeley (f. 392). Handmacher, who was respondent's brother-in-law, at first denied that he asked respondent for any part of the proceeds of the sale of respondent's employment contract to Grayson—

then he qualified that answer by saying that he did not ask for any part of the said proceeds *on behalf of himself*, but did ask on behalf of his wife and her sisters (ff. 407-408). Handmacher admitted his unfriendliness toward respondent ever since they had come into the store (f. 397); he denied that the unfriendliness developed as a result of respondent's refusal to recommend a salary for Handmacher as chairman of the board of directors; but he said he was promised a number of things, and respondent failed to recognize or remember any of the promises respondent had made to him (f. 397); and that there had been an understanding about salary but it was only between respondent and himself (f. 400).

Petitioner developed (with respect to the $50,000 check) as the Trial Judge said, *"Nothing but a disclosed transaction.* It appeared on the books of the corporation" (f. 255).

(b) With regard to the check to respondent for $13,000, dated September 5, 1944, respondent testified it was a temporary loan, entered on the stub in the check book *in his name* as an "Even Exchange", after discussion with one or more members of the executive committee (ff. 264, 527); *it was fully disclosed on the books* of the corporation; the accountants and auditors were apprised of it and knew what the transaction was (ff. 264-265). The $13,000 loan was repaid before the end of the month, viz., *on September 28, 1944* (f. 265). Both this loan and the $50,000 loan were discussed with the directors (f. 275).

Respondent testified, with reference to the $13,000 check dated September 5, 1944, that the Klein fiscal year ended September 30th and that there would be an estimated sum then due him by virtue of his five per cent. agreement in excess of $13,000 (ff. 306-307); but on recapitulation, by

virtue of certain allowances and expenditures made for improvements (whereby the net profits were reduced) the sum then payable to respondent was reduced to $4,309.96 (ff. 307, 426)—respondent's impression at the time of drawing the $13,000 check was that there was actually coming to him from the corporation at the end of that month a sum in excess of the $13,000 (f. 307)—in any event the whole amount of $13,000 was repaid before the end of the month.

(c) In summary, with respect to the two checks, these matters took place approximately a year and a half before the closing of petitioner's purchase of the Klein securities, during which period they were not questioned by anyone. They appeared openly on the books of the corporation. Jayson, a public accountant associated with Alson & Brown, the accountants for Klein, testified that he worked on the audits for the months of August and September, 1944 (f. 411), and the books for those months showed these withdrawals (with the check stubs showing respondent's name and the notation "Even Exchange"); and the return of the moneys in each case within the month (ff. 418-420). Klein was at all times fully advised about the transactions; and never objected thereto. It was approximately three months after the second of these check transactions that the respondent's salary as president and executive director of Klein was increased by resolution of the board of directors and the unanimous vote of all the stockholders (f. 449).

Petitioner apparently attached some significance to the fact that the transactions did not appear in the monthly financial statements of Klein, but, as the Trial Court said (and as Handmacher agreed) "The transaction having been liquidated inside of a month, it would not appear on the financial statement" (ff. 389-390).

Petitioner's accountants and auditors examined the books of account (showing the said transactions) before the closing (f. 350). Petitioner, after such examination, expressed itself as satisfied, and prepared to close and did close the deal (f. 485).

Under all the circumstances it is apparent that the transactions with respect to the checks (which were plainly, as the Court below said, at the most "technical irregularities") would have afforded Klein no basis or ground for terminating respondent's employment contract—still less has the petitioner any right to raise any question in that regard.

(7)

Petitioner relied greatly in the Court below on the alleged representation which it claims was made by respondent to Diamond that respondent's contract of employment was a valid contract "free from infirmities".

The alleged representation is repeated many times in petitioner's petition and brief; as though by frequent repetition it might gain some added strength.

(a) Petitioner's position in this respect is without any support in the record. In the first place Diamond's testimony did not establish the making of the alleged representation. Diamond said, on his direct examination, that respondent told him he had a valuable contract "free from infirmities" (f. 316); though respondent denied the making of any such statement (f. 187).

On cross-examination, however, Diamond admitted that he was unable to testify that respondent used the words quoted—he said that was *the meaning he placed upon them* (f. 345); that was *his understanding* of the words used (whatever they were) (f. 346). He testified merely to *his*

interpretation of what respondent said, without testifying, either in words or substance, to what respondent did say (ff. 344-346). His testimony falls far short (as a matter of law) of affording a basis for avoiding a contract on the ground of alleged misrepresentation or alleged fraud.

The alleged statement, even if it were made, was wholly insufficient to make out a case of alleged misrepresentation or fraud. *For one thing, it was true.* The so-called "infirmities" (or "grounds for termination") which petitioner contends existed in respondent's contract, were either those specifically pleaded in the petitioner's second defense in its amended answer (which were *abandoned without proof* upon the trial) or the new objections (not pleaded) raised for the first time on the trial—with respect to which (as hereinabove pointed out) petitioner wholly failed to make out a case.

(b) As far as concerns petitioner's claim of alleged *fraud* (which constitutes the second alleged counterclaim in petitioner's amended answer) none of the elements essential to fraud was here present.

The respondent's alleged statement that he had a valuable contract was true—it was at the time of its assignment *an existing contract of great value, and was so regarded by both the parties thereto.*

Moreover, there was no proof of the element (essential to fraud) of reliance upon the alleged statement—on the contrary, it is negatived by the testimony on petitioner's behalf. Petitioner, through its attorneys, auditors and accountants, made a full and complete *independent investigation*—and it was as a result of that independent investigation that petitioner announced it was satisfied and prepared to go ahead and close the transaction. Where a party relies on his own investigation and not on the alleged

representation, he cannot, so far as a charge of *fraud* is concerned, base such a charge upon the representation, for the purpose of avoiding a contract which he makes in reliance on his own investigation. (*Eppley* v. *Kennedy*, 131 App. Div. 1, 5 [rev'd on another ground 198 N. Y. 348]; *Sacramento Suburban Fruit Lands Co.* v. *Klaffenbach*, 40 F. 2d 899, 903.)

Petitioner knowingly and willingly (after full and careful investigation) entered into the agreement with respondent for its own benefit and advantage.

Petitioner in its brief admits the making of its investigation of Klein's books and papers prior to the closing of the contracts on February 28, 1946; but says that the investigation was made with reference to the contract for the sale of the securities and not the contract for the assignment of respondent's employment agreement—this attempted hair-splitting is, however, wholly ineffectual—the two contracts were interrelated; one was conditional on the other; the petitioner's investigation was made for all purposes and included all the books and papers; at its conclusion petitioner expressed its satisfaction therewith and both contracts were thereupon closed at the same time on the same day. The importance of the investigation (from petitioner's point of view) was brought out in Diamond's testimony, in answer to the Court's questions (ff. 351-352, 369).

(8)

Petitioner further contends that it may not be held to the promise it made to respondent for the reason that there was *an alleged failure of consideration* therefor. But here again there is no basis for petitioner's contention.

(a) This alleged failure consideration is based mainly upon petitioner's claim that respondent did not sell and

assign to petitioner "a valid and subsisting contract free from infirmities"—in other words, it is the same contention on the part of petitioner (so frequently repeated in its petition and brief) which has been heretofore considered herein and shown to be without merit. Respondent had an existing valuable contract; and the so-called "infirmities" which petitioner alleged or sought to prove therein simply did not exist.

(b) It was further set forth in petitioner's alleged "second defense and first counterclaim" and urged by petitioner upon the trial and in the Court below that respondent's agreement with petitioner to resign as an officer and director of Klein and its subsidiaries constituted no consideration, for petitioner's promise to respondent, for the reason (as alleged by petitioner) that respondent was already bound by the contract for the sale of the securities to resign as officer and director.

The agreement whereby petitioner agreed to purchase the securities and its agreement to purchase respondent's interest in his employment contract were (as more fully pointed out above) parts of a single transaction. The agreements were made on the same day; they were simultaneously executed; they were caused by petitioner to be printed and bound together under one cover (Plaintiff's Exhibit 7, f. 175); petitioner's agreement with respondent for the purchase of his interest in the employment contract was made conditional, and only to become effective, upon the closing of the contract for the purchase of the securities; and respondent would not have entered into the agreement for the sale of the securities unless petitioner had agreed to purchase his interest in the employment contract (f. 336). *The elements of consideration for the one agreement entered into and formed part of the other.*

The contract for the securities contained the broader provision for the general resignation of "all directors, officers, attorneys-in-fact and agents of the corporation and its subsidiaries" (f. 452); petitioner's agreement for the purchase of respondent's interest in the employment contract contained his specific agreement "to resign as an officer and director of said company and its subsidiaries"—neither agreement for resignation preceded the other (as petitioner contends herein); they were simultaneous and formed parts of the entire transaction.

Moreover, as appears from the colloquy between the Trial Court and petitioner's counsel, petitioner attached a special value and importance to respondent's specific resignation—petitioner was evidently of the impression that under the provision for the general resignations respondent would still remain as manager or executive director (ff. 126-127); and the specific agreement was to make sure that respondent's relation to Klein *was in all respects severed* (f. 375)—petitioner wanted respondent out in all capacities and for all purposes. In this view petitioner plainly regarded the specific agreement for respondent's resignation as having a special value; and as constituting a special consideration for petitioner's promise.

As Diamond testified, it was "because defendant did not want Stone in the management in any capacity including that of an executive and did not want any possible assignee of his to interfere, it agreed to purchase his rights for $200,000" (f. 375).

(c) It is said further by petitioner that respondent's promise in his agreement for the sale to petitioner of his interest in his employment contract "to refrain for a period of six (6) years from the date of closing from assuming a position of general executive duties and responsibilities with

any ladies' apparel department store in the Borough of Manhattan", furnished no consideration for the petitioner's promise sued upon herein, for the reason, as alleged by petitioner, that respondent had already made such a promise in petitioner's agreement to purchase the Klein securities.

That there is nothing to petitioner's contention in this respect is r .dily demonstrated. The provisions in the two agreements are essentially and materially different.

The provision in the agreement to purchase the securities of Klein merely restrains the officers, directors, debenture holders or stockholders of S. Klein on the Square, Inc., from entering upon a competitive business *"under the name 'Klein'* or any imitation or simulation thereof" (f. 451)—this paragraph does not limit or restrain the respondent generally from engaging in a competitive business—it restrains him merely from engaging in such a business under the name *"Klein or any imitation or simulation thereof"* (See also the clarifying letter, ff. 495-496). Respondent might under this agreement engage in a similar or competitive business as long as it was not under the name "Klein" or any imitation thereof. This is very different from the restraint imposed upon respondent in his contract with petitioner (which is the subject of this action) whereby respondent was obliged generally "to refrain for a period of six (6) years from the date of the closing from assuming a position of general executive duties and responsibilities with any ladies' apparel department store in the Borough of Manhattan, City and State of New York."

Respondent, as president and executive director, had successfully managed and operated the Klein business for nearly two years; it was, accordingly, to petitioner's advantage to restrain respondent for the period named "from

assuming a position of general executive duties and responsibilities" with any other ladies' apparel department store in the Borough of Manhattan. The restrictive covenant was plainly regarded by petitioner as something of substantial value; that was why petitioner, in the prospectus and registration statement which it filed with the Securities and Exchange Commission on March 4, 1946 (upon its application for approval of the issuance of new securities) recited (as one of the advantages of its purchase of respondent's employment contract) that respondent had agreed to resign as an officer and director of Klein and its subsidiaries and to refrain for six years "from assuming a position of general and executive duties and responsibilities with any ladies' apparel department store in the Borough of Manhattan, City and State of New York" (ff. 365-370), (Plaintiff's Exhibits 13 and 14).

In this connection it might be noted that although petitioner, in these documents filed with the Securities and Exchange Commission (four days after the closing of the Klein transaction) purported to set forth all the advantages resulting to petitioner from the transaction and to put it in the most favorable light, petitioner nowhere mentioned therein any of the alleged warranties or representations which are now claimed to have been made by respondent.

(d) In any event, it may be said that a sufficient consideration for petitioner's promise is found in the *detriment* to respondent (in his change of position whereby he gave up rights which were to him of great value, with an assured income); and in the *advantages* to petitioner, even though (as the Courts below have pointed out) they might be nothing more than freedom from a lawsuit, in which petitioner (in its effort to oust respondent) would certainly have been otherwise involved (ff. 104, 110).

(9)

In the so-called "third defense and third counterclaim", which was first pleaded in its second amended answer, petitioner alleges that respondent's employment contract was one for personal services; that as such it was not assignable without the consent of Klein, which consent it is alleged was not obtained; and that, therefore, respondent's assignment to petitioner of his rights in said contract was not valid and constituted no consideration for petitioner's promise. It might be said that throughout the proceedings that culminated in petitioner's purchase of the securities and of respondent's contract, petitioner was represented by counsel (who prepared both contracts)—it is now very late in the day for petitioner to raise this highly technical objection.

It is evident that in this alleged defense (and in its argument in support thereof) petitioner has confused the situation here presented with cases where the purpose of the attempted assignment of a contract for personal services is to substitute another to perform and carry out the contract in lieu of the assignor. Of course, that cannot be done without the consent of the employer—the employer has the right to say by whom the services to be rendered to him shall be performed. The rule has been stated: "A contract for services personal in their nature cannot be assigned by the employee *so as to enable the assignee to require the employer to accept performance by him*" (Clark, New York Law of Contracts, vol. II, §763, p. 1134). The cases cited in petitioner's brief in support of that proposition are not questioned herein.

The situation, however, is manifestly different where (as here) the employee's interest in his employment contract is acquired by another, not for the purpose of enabling

the other to perform the contract, but to *terminate* the contract and *extinguish* the employee's rights thereunder—where, as is said in petitioner's brief "the purpose of the assignment is not to obtain benefits under the employment contract, but to terminate the acquired rights." As the Trial Court said, in the colloquy with petitioner's counsel, "Actually you were merely buying freedom from his presence in the plant" (f. 108), "You didn't become the beneficiary of the five per cent profit when he sold you that contract. You didn't become the beneficiary of his salary payments * * *. All you had was freedom from Stone's presence in the management" (ff. 113, 118).

In any event, consent of Klein to the assignment of the employment contract was obtained herein. The board of directors, at the meeting held on February 5, 1946, and the stockholders, at the meeting held on the same day, were fully advised (as respondent testified, and it is undisputed) with respect to both agreements entered into with petitioner—the directors and stockholders did not need to be advised of the agreement with petitioner of February 2nd for the sale of the securities, inasmuch as they were all parties thereto (Plaintiff's Exhibit 7); and they doubtless knew also of the respondent's separate agreement with petitioner made at the same time and as part of the same transaction—that they were fully advised appears from the minutes of both meetings (ff. 504, 509). Formal consent, however, on the part of the directors and stockholders to the assignment of respondent's employment contract, was evidently wanted by petitioner in order to make the record complete; and such consent (at petitioner's request) was given accordingly.

At the special meeting of the board of directors there were six directors present (including respondent) out of a total of ten members. The resolution approving the assignment of respondent's contract was voted unanimously

(f. 504). Petitioner contends, however, that the vote was invalid for the reason that respondent's presence was necessary to make a quorum; but the meeting was called to transact and did transact other business (for which there was unquestionably a quorum) than the voting of this particular resolution. Moreover, the assignment which the directors approved was not anything that conferred a benefit on respondent *at the expense* of the corporation of which he was an officer and director—respondent did not thereby acquire anything from the corporation—wherein the instant case is distinguishable from the cases cited on this point in petitioner's brief.

With respect to the stockholders' meeting it was said by petitioner in its brief in the Court below that no waiver of notice of the meeting appears in the minutes. Respondent testified (and it is not disputed) that a waiver was signed by all the stockholders—those not present at the meeting signed it subsequently either at respondent's or Diamond's office—every single stockholder signed it (ff. 214-216); and that the waiver was turned over to Diamond or to Adler, who was not called as a witness by petitioner (f. 217).

As hereinbefore pointed out, the books containing the minutes were delivered to Adler on February 8th; he examined them, and Diamond testified (in answer to the Court's question) that any questions Adler raised were satisfactorily resolved (ff. 359-360). Petitioner had the minutes *for a period of 20 days* prior to the closing.

It is now far too late for petitioner to raise technical objections in connection with the minutes as to matters (either with respect to quorum or the proceedings had at the meetings) which could readily have been obviated at the time and which were then acquiesced in and approved by petitioner.

II.

In Reply to Petitioner's Brief.

(1) It is said (on page 15 of petitioner's brief) that its agreement to pay $200,000 to enable Klein to terminate the employment contract was "premised on the assumption that that purpose could not be achieved *free of charge.*"

This statement brings out (more candidly than most of the petitioner's brief) its real aim and purpose; and at the same time plainly illustrates the unsoundness of its position and the fallacy of its argument.

Petitioner's grievance is apparently that it agreed to pay respondent $200,000 for what it alleges it might have had *for nothing*—that facts which it is alleged were unknown to Klein or petitioner until after the closing "would have allowed Klein to terminate the employment contract *without any cost* to itself or petitioner."

The unsoundness of petitioner's position in this respect is readily demonstrated. Petitioner assumes that it could have obtained the securities and control of Klein without the purchase of respondent's employment contract. But the fact is, of course, otherwise. Petitioner could not obtain the securities and the control of Klein (to enable it to exercise any alleged right that Klein might have to terminate the contract) unless the respondent consented thereto and joined in the agreement for the sale of the securities. *This the respondent would not do* unless an agreement for the sale of his employment contract was entered into at the same time.

Respondent concededly was a substantial owner of the securities, and he had certain priorities affecting the right of other stockholders to part with their shares of stock to outsiders (ff. 333-334)—his consent was essential if there

was to be a sale of the securities to petitioner; and his consent could not be had unless petitioner bought out his employment contract. There was, therefore, no way in which petitioner could obtain, with respect to respondent's employment contract, the "free ride" at which it now looks so longingly.

It is said several times in petitioner's brief that a "tentative agreement" for the sale of the securities was negotiated before the question of respondent's contract came up—it could not have been otherwise than "tentative", because without the agreement for the purchase of respondent's employment contract, there never could have been any agreement for the sale of the securities.

(2) If in any way petitioner could have obtained the securities and control of Klein, without at the same time purchasing respondent's employment contract (which, as shown above, was impossible) and then petitioner had caused Klein to terminate respondent's employment, petitioner would have undoubtedly been involved in litigation of a most serious character. This was, in part at least, what the Courts below referred to when they said that by the purchase of respondent's employment contract, petitioner was buying its freedom from a lawsuit. It is, therefore, difficult to understand petitioner's statement (on page 25 and elsewhere in its brief) that there is no support whatever in the record for the finding of the Courts below "that petitioner's object was to get rid of respondent without a lawsuit or dispute"—it is too plain for further discussion that if petitioner had attempted to get rid of respondent in any other way than by the purchase of his employment contract, a formidable lawsuit would surely have followed.

(3) Petitioner refers in its petition and brief to the Court's modification of its opinion on the denial of the petition for a rehearing. In its opinion as originally prepared the Court below said that Diamond's testimony as to the alleged representation made to him by respondent "was not enough to serve as a foundation for a defense of fraud or misrepresentation, or express warranty." In this the Court was (as shown more fully on pages 33-34 hereof) undoubtedly correct. In order, however, that there might be no misunderstanding or uncertainty with regard to the basis of its decision, the Court modified its opinion to say that it would regard Diamond's testimony (vague and uncertain as it was) as amounting to an express warranty, but that, nevertheless, it would afford petitioner no basis for relief herein—for the reason that the alleged express warranty (if made) was *true*—respondent had a valuable contract which he was surrendering and as to which there existed no ground whatever, at the time of its assignment by respondent to petitioner, on which it could be assumed that Klein would terminate (or would have any right to terminate) the contract.

(4) Petitioner, in its petition and brief, misinterprets the opinion of the Court below where it said that the meaning of the alleged express warranty was "only that Stone was giving up a valuable contract which would not be rescinded by Klein." It is said by petitioner that neither the Court nor respondent had any means of knowing that Klein, after petitioner had obtained his control, would not then rescind respondent's employment contract. Here again petitioner assumes that it could have obtained the securities and control of Klein without the purchase of respondent's contract and his accompanying resignation. It is entirely clear that what the Court below meant when

it said that Stone was giving up a valuable contract "which would not be rescinded by Klein" was that while respondent's employment continued and the control of Klein was as it was, there was, as a practical matter, *no possibility whatever* that respondent's contract would be terminated or rescinded by Klein.

(5) Numerous cases are cited on pages 15 and 16 of petitioner's brief to the effect that misrepresentation upon a material point will justify rescission. The doctrine of the cases cited is not questioned herein; but they have no bearing upon the instant case, where (as shown above) (1) there was no sufficient proof of any representation made by respondent; and (2) if it be assumed there was any representation, the same was *true*.

On page 32 of petitioner's brief cases are cited to the effect that the officers and directors of a corporation act in a fiduciary capacity in handling its affairs—no one disputes that proposition; but it has no relevancy to the facts disclosed herein. Similarly, it is said, on page 33 of the brief, that under the law of New York an employee or agent may be discharged before the expiration of his term for negligence or inefficiency—that statement also is not open to question, but it has no application herein.

In like manner there are a very great number of other cases cited throughout the petition and brief; but upon analysis it appears without exception that they have no bearing upon the questions presented herein.

(6) The petition and brief (in connection with the above-mentioned checks for $50,000 and $13,000) refer repeatedly to what are therein termed respondent's "admissions of misconduct" and "admissions of conversion" of funds of the corporation. It is hardly necessary to say that

there were no "admissions of misconduct" by the respondent—the whole record shows the contrary. The check transactions (as shown above) were entirely proper; they were had with proper authorization; they were fully disclosed on the books of the corporation; and no objection was ever made thereto.

Both the petition and brief are filled with extravagantly improper and wholly unfounded and unjustified characterizations of respondent's conduct, such as "defalcations", "depredations" ("petitioner's depredations" they are termed on page 3 of the petition), "conversion" of funds and of other personalty, and the alleged "fraudulent write-off." These expressions, by frequent repetition, are sought to be given some weight; but it has been said that "Calling names does not alter facts"; and the *facts* are all against the petitioner.

The alleged conversion of other personalty has reference, in the last analysis, only to the used *radio,* whereof there was in the testimony no proof whatever of any conversion by respondent. As to the alleged "fraudulent write-off" of charges for merchandise in respondent's account, the proof clearly negatives any fraud. It might be noted that respondent's five per cent of the net profits (under his employment contract) had been accruing since the preceding September—they would in ordinary course more than offset the charges against respondent on the books; petitioner, by taking over the business at the end of February, made such an off-set impossible; and it was, therefore, entirely reasonable and proper that respondent should insist upon petitioner's consent to the said write-off as part of the whole transaction. That consent was given in Kuchai's letter to respondent, dated February 9, 1946 (Plaintiff's Exhibit 9). As respondent testified, part of the consideration for the sale of his contract, whereby his employment

with Klein was terminated, was the cancellation of the charges in his account (f. 222). If there was any misrepresentation to Klein in this connection, Klein alone would have a right to object thereto— and Klein never made any objection. Respondent's denial that he ever told Kuchai, petitioner's president, that the merchandise charged to him was mainly distributed for the benefit of the business stands uncontroverted—it is significant that Kuchai was not called by petitioner to take the stand.

All of these matters, viewed in the light most favorable (or it may be said most charitable) to the petitioner, were nothing more than "*technical irregularities*", as they were termed by the Court below. There is not the slightest reason to suppose that, had the facts been as petitioner tried unsuccessfully to establish them, they would in any way have affected the closing of these transactions involving, as they did, respectively, amounts of $2,500,000 and $200,000.

(7) With respect to the alleged implied warranty, it is said, on pages 23-24 of petitioner's brief, that the Court below erred in holding that a warranty might not be implied with respect to an item not purchased for exploitation. The Court below said that a warranty would be implied only where the facts did not show a *contrary intention*. It is conceded throughout petitioner's brief that its intent and purpose in acquiring respondent's employment contract was to terminate and extinguish it, rather than to perform or exploit it. An implied warranty upon the sale of personalty is one of *fitness for the purpose* for which it is intended; and where the intent is the extinguishment of the subject matter, there will, manifestly, be no implied warranty other than that of fitness for the purpose intended, that is, its termination or extinction. The Court was, there-

fore, right in holding that there did not exist herein the implied warranty contended for by petitioner.

(8) It is said, on page 25 of petitioner's brief, that the Court below ignored "the sheer magnitude of the $200,000 purchase price as compared with what respondent was to receive under the employment contract itself"; and in its further effort to minimize the importance and belittle the value to respondent of his employment contract, petitioner says (on p. 18) that "for the fiscal year ended September 30, 1944, respondent's share of the profits under the employment contract was $4,309.96." Petitioner does not go as far as to say (as it did in its reply brief in the Court below) that respondent conceded his 5 per cent. for the year ending September 30, 1944 was approximately $4,000. The fact is, of course, that Klein was not incorporated until about April 15, 1944; and therefore, the sum above mentioned represented respondent's percentage only over a period of *5½ months*—a period which was, moreover, one of adjustment to new conditions and of making allowances and expenditures for improvements, which operated to reduce the amount of respondent's percentage even for that limited time (f. 307).

Petitioner's statements in this connection are on a par with the evasive testimony of Diamond. His testimony on many points was apparently designed to convey a misleading impression, until in each instance the Trial Court pinned him down and by its questions brought out the actual facts (see Diamond's testimony, particularly as to whether petitioner wanted respondent out, fols. 372-375; and in other instances at fols. 360-361, 362, 333-335, 337-338, 345-346). Diamond's testimony throughout was lacking in the frankness and candor which the Court had a right to expect from a member of the bar. It culminated in his absurd assertion

that the covenant restraining respondent, during a period of six years, from taking an executive position with any ladies' department store in the Borough of Manhattan, was inserted in his contract with petitioner at respondent's request.

(9) It is said, on page 27 of petitioner's brief, that the fact that the two contracts with petitioner were made on the same day affords no basis for the conclusion that the making of one formed part of the consideration for the making of the other; and petitioner cites (on pages 10, 27 and 29 of its petition and brief) the case of *Petze* v. *Leary*, 117 App. Div. 829, in support of its position. Petitioner quoted from the opinion in that case in its brief in the Court below; but omitted to quote from the opinion the next succeeding paragraph to the effect that if the making of the contract with the corporation had been the consideration for the promise of the individual defendant (sought to be enforced against him in the action) or if the plaintiff therein was induced to enter into the contract with the corporation by reason of the defendant's promise, there would have been a sufficient consideration for defendant's promise. In the instant case the proof shows such consideration, for it clearly established that respondent would not have consented to the sale of the securities of Klein to the petitioner if petitioner had not made the separate promise to acquire respondent's interest in his employment contract.

Conclusion.

The substantially uncontroverted proof herein established that respondent had rights of great value which he transferred to petitioner in exchange for its unfulfilled

promise—that the whole purpose of petitioner is to get out of its bargain.

The judgments of the Courts below were right; and no reason is shown why their enforcement should be further delayed.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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